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Bancassurance in China

Reaching the Next Level

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Preface

China's bancassurance market is growing at breathtaking speed. At the same time, it appears to be locked in a paradox. Banks are already the dominant sales channel for life insurance in China, and are propelling the country's rapid growth in premium volume. However, the breadth and sophistication of currently available products—as well the overall quality of customer service—lag far behind bancassurance activities in many other countries. The result is a rapidly developing, yet unusually *under*developed market.

Several factors have contributed to the present situation. First, banks obviously have considerable marketing power in the financial services arena. They also are permitted to sell multiple brands of insurance—although they are not yet allowed to own insurers outright. The resulting model is one in which banks often sell relatively unsophisticated savings-type products—offerings that carry a variety of brand names—in an untargeted way. We call this structure "many-to-many."

Why, then, don't insurers develop better-tailored products and service for the bank channel? First, there is little incentive for insurers to train banking staffs in product detail and advanced sales techniques when this expertise will be used, at least in part, to sell their competitors' products. In addition, insurers already pay generous commissions to banks for "shelf space," hurting their own profitability and ability to invest in innovation.

There is, however, a growing recognition that the present market structure is not sustainable. Indeed, Chinese regulators are already working on bancassurance reform in order to promote better integration of banks and insurers. We believe that this initiative will push China's market in the direction of more mature bancassurance markets. More specifically, we are likely to see a period of heavy investment in product development, marketing, customer service, and platform synergy. The insurers and banks that are leading this push will be in a position to build significant competitive advantage in the market. The prerequisite for success, however, will be the forming of exclusive partnerships—of various natures—so that investments of capital and know-how can be protected and generate positive results.

Banks and insurers alike will need to think through the different options available to them—taking their specific capital resources and distribution networks into account—and adopt a strategy that is aligned with their long-term aspirations. Betting on the right strategic option *now* and ensuring best-in-class execution can result in extraordinary benefits.

Executive Summary

- Bancassurance has already emerged as China's biggest platform for life insurance sales, yet it currently operates on a "many-to-many" distribution model. This model has been facilitated by regulations that allow banks to sell the products of multiple insurers side by side.

- In the long run, the many-to-many model is not sustainable. Simple analysis of operating profits suggests that bancassurance does not create significant value for insurers in China today. In giving banks more leverage over the insurers whose products they sell, the many-to-many model fails to incentivize product, marketing, or service innovation among insurers. Banks have little motivation to change this system because it provides them with handsome commissions.

- The lack of product diversity and sales know-how resulting from the current system is starting to impact demand for insurance products sold through banks. With overall penetration still low, however, both life and non-life insurance premiums in China should continue to grow annually by double digits, supported by broader macro trends. Still, although the size and wealth of the relevant buyer group will continue to mushroom, the growth of bancassurers will be weakened if they are unable to take a larger share of wallet from increasingly sophisticated and demanding customers. Other insurance distributors, such as agents and brokers, might win back market shares once lost to banks.

- In order to remain competitive, bancassurers will have to widen and upgrade their product lines and improve their customer service models—in essence, giving customers more and better products in a more targeted, service-oriented way in order to create brand loyalty. This will require substantial investment.

- Banks and insurers will also have to forge more exclusive and better integrated partnerships in order to justify these investments. There are four bancassurance partnership models that, depending on each party's needs, have proven to be successful: exclusive distribution partnership; joint venture; financial holding company; and integrated line of business (which takes an organizational rather than legal-entity point of view).

- Sharp execution of these partnerships—whose scope can vary from regional to national and from single- to multi-product—is critical. In particular, partners will need to focus on initiatives that form the 10 building blocks of a successful bancassurance model: develop products jointly; streamline products; adopt a generalist sales model; create meaningful sales targets and incentives; bundle products for life events; train rigorously; upgrade IT systems; define organizational roles; bolster customer service and post-sale support; and ensure capital and risk management.

- In sum, we believe that the market-share land grab chapter of China's bancassurance saga is nearing an end. Winning in the emerging competitive phase will require quantum improvements in product innovation and in the integration of marketing and distribution. All of these goals can be achieved only through the introduction of more, deeper, more-exclusive, longer-term partnerships between banks and insurers.

A Brief Introduction to China's Insurance Market

Overview

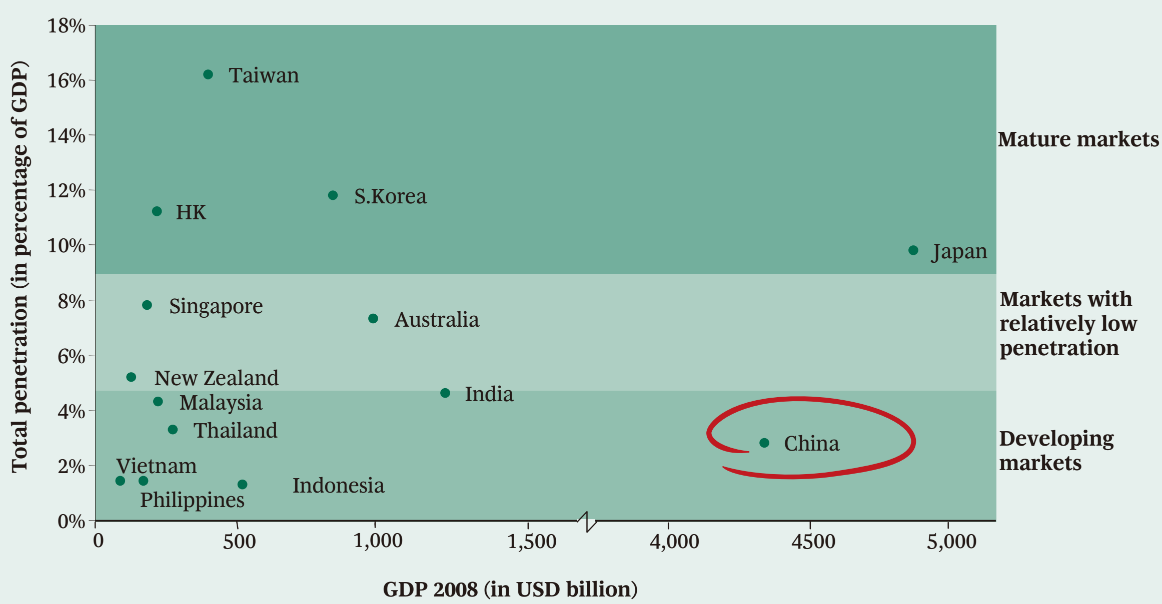
China's insurance industry is still young—and it is booming. The country's $108.7 billion in life insurance premiums in 2008 represented nearly a twelve-fold increase over the 1998 level.[1] In 2010, life insurance premiums in China could well exceed $150 billion, leaving Germany, currently ranked fifth worldwide in terms of life premiums, far behind. China's non-life sector is also poised for strong growth. Non-life premiums, for the first time, exceeded $30 billion in 2008.

In percentage terms, China's insurance industry has expanded rapidly over the past decade, with life premiums growing at about 28 percent annually and non-life premiums increasing at roughly 20 percent annually. Compared with other global markets, however, penetration as a percentage of GDP remains relatively low. For instance, in Asia, the insurance markets in Malaysia, Thailand, Hong Kong and Taiwan all have higher penetration rates. (See Exhibit 1.) This underscores the growth potential that the highly populous Chinese market holds.

This potential is supported by extremely attractive fundamentals. On the demand side, overall wealth in China is increasing. Household-savings rates, at around 35 percent of income, are impressively high. Retail deposits, around $3.3 trillion at the end of 2008, represent roughly seven times the total assets of Chinese insurers and 20 times those insurers' bank deposits. In addition, the Chinese population is ageing and investment options in the country are still limited.

1. All currency references have been converted to USD at a $1=RMB 6.85 exchange rate.

Exhibit 1. China's Insurance Market Still Offers Tremendous Growth Potential



Meanwhile, supply is expanding fast, causing rapid proliferation of new sales channels and a ratcheting up of marketing efforts. At the same time, regulators have started to consider financial integration more seriously; for example, banks have recently been allowed to buy stakes in insurance companies.

Bancassurance in China—A Story of Explosive Growth

The practice of selling insurance through banks—known as bancassurance—has grown at a particularly brisk pace in China in recent years. In 2002, bancassurance premiums amounted to just $730 million. But after a 2003 insurance regulation stipulated that banks were no longer limited to representing just one insurance firm, premiums started to explode, reaching $11 billion in 2004. In 2008, Chinese bancassurers sold $52 billion in life premiums, about 48 percent of total life premiums in the country. Today, banks and insurers are starting to develop far-reaching strategic moves in this sector.

In a country as vast and diverse as China, it is hardly surprising that bancassurance has taken hold so quickly. Banks, with tens of thousands of branches, provide convenient sales platforms that reach into every corner of every province. Through these branches, insurers can leverage the brand reputations of banks to gain footholds in new markets. Also, by cooperating with banks, insurers gain access to a vast customer base with strong potential interest in insurance products—especially those designed to replace bank deposits. In addition, setting up bancassurance as a distribution channel is initially relatively inexpensive for insurers, especially when compared to the costs of building up and maintaining their own agencies.

The current system also allows banks to broaden their overall product offering, strengthen customer loyalty, and add more fees to their otherwise interest-rate-dominated revenue mix. Indeed, bancassurance generated around $1.5 billion in commission income for Chinese banks in 2008.

When it comes to the current bancassurance landscape in China, the insurer side has fairly high market concentration. The top two life players in this arena—China Life and New China Life—held about 50 percent of the market in 2008. These giants, along with five other institutions, accounted for nearly 90 percent of the market in 2008. (See Exhibit 2.)

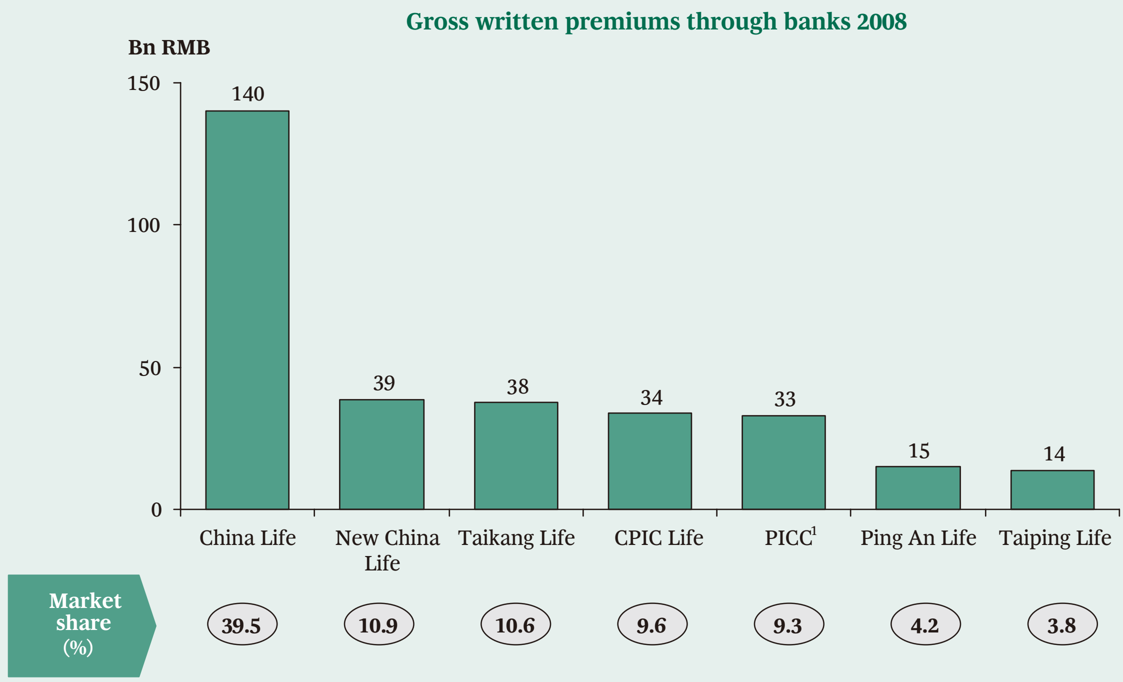
This is not to imply that the bancassurance model is not prevalent among smaller industry players as well. In fact, most small and medium-sized insurance companies rely heavily on bank channels and on savings-type products. Consequently, in the first half of 2009, bancassurance sales still accounted for nearly 40 percent of total premiums in China despite a general trend toward fewer savings-type products (resulting from the global downturn of investment markets).

In fact, virtually every Chinese bank has been selling insurance products on commission for at least several years, some starting as early as 2000. The regulatory change in 2003 that enabled banks to represent multiple insurers allowed the "many-to-many" model to arise, and the result has been a jumble of products and brands being offered in bank outlets. For instance, the products of the top two insurers are sold by nine of the top ten Chinese banks. On the flip side, the two largest lenders both sell the products of 12 of the top 15 insurers in China, including those of all of the top six providers.

To further complicate the picture, the mix of insurance brands offered at any one bank tends to differ from province to province. Negotiations over which brands to carry often occur at the branch level, leading to potentially inefficient—and in some cases dicey—business practices when securing distribution deals.

Ultimately, although the many-to-many arrangement has paved the way for momentous growth in the past few years, it has also brought the Chinese bancassurance market to its current impasse. Simply put, the

Exhibit 2. China's Life Bancassurance Market Is Highly Concentrated



Source: China Insurance Yearbook 2009.
[1]PICC Life and PICC Health.

necessary investments by true bancassurance partnerships into better products and service that will lead to profitable, sustainable growth in the future are not yet being made.

The Next Wave of Growth

The "Many-to-Many" Model: An Imbalance of Power

Simple analysis of operating profits suggests that bancassurance does not create significant value for insurers in China today, largely because of the mostly simple, low-margin products sold through banks. Also, insurers lack bargaining power vis-à-vis banks—which, in turn, benefit disproportionately from the system.

Indeed, with insurers competing against each other on distribution commissions, banks are able to enjoy a relatively large slice of the pie. Not surprisingly, while bancassurance premiums represent an ever-larger share of total premiums, operating-profit margins for insurers may actually be falling. Insurers have had few choices, however, given the system. Moreover, those that have not established a wide market presence through relationships with different banks may have missed out on the current land-grab phase of market development, which is already winding down.

These imbalanced conditions between insurers and banks may have spurred the rapid expansion of the Chinese bancassurance distribution model, but they have also hindered the development of more sophisticated bancassurance models. If this inequality is not at least partly balanced, insurers, customers, and finally banks as well will increasingly suffer from a vicious cycle of sluggish product development and weak innovation. Other distribution channels might ride higher on the next growth wave if bancassurers continue to miss crucial opportunities to meet their clients' true, and evolving insurance needs.

The Need for Product and Service Innovation

Against this backdrop, major yet untapped sources of growth will be the broadening of product offerings, the improvement of financial advice, and the development of more (and better) peripheral services. Moreover, the potential for growth and innovation is obvious when viewing China next to many other markets. For example, the breadth of bancassurance products available in China is far narrower than that in Spain—which despite being far less populous is one of the world's most robust bancassurance markets. (See Exhibit 3.)

Most products sold through China's bancassurance platforms are by nature savings products. A few standalone protection products are sold, but virtually no health or pension insurance is available via banks. Similarly, Chinese bancassurers distribute very few types of non-life products. Those that are available—motor, property, and creditor protection, for example—are sold in miniscule volumes. What's more, the focus is entirely on individual lines. Truth is, the product range offered in the Chinese bancassurance market is still dwarfed by the white space.

The story on the services side is similar. Since the same bank staff sell multiple insurance brands, insurers have little incentive to train them either in salesmanship or in post-sale customer service. Both elements,

Exhibit 3. The Chinese Bancassurance Market Is Far Less Evolved Than the Spanish Market

Product line	Product	Spain	China
Life & Health	Life (protection-oriented)	●	◔
	Life (savings-oriented)	●	●
	Group life	◕	○
	Personal accident	◕	◕
	Critical illness	◕	◔
	Disability & long-term care	◕	○
	Private health	◕	◔
	Individual pensions	●	◔
	Mortgage endowment	●	○
Non-Life	Motor third party liability	◕	◔
	Motor own damage	◕	◔
	Household	●	◔
	Fleet insurance	◕	○
	Agricultural	◕	○
Credit protection insurance (CPI)	Simple covers (Term, PD)	●	◔
	Loans death	●	◔
	Mortgages (death & disability)	●	◔
	Loans unemployment	●	○

○ = Virtually unknown ◔ = Pioneer providers ◕ = More widely available ● = Standard offering however, are essential for promoting more-sophisticated products. Moreover, for banks to meaningfully engage in post-sale service, they would have to reduce the variety and choice of brand names they offer, potentially undermining the perceived competitiveness of their product portfolio.

Anecdotally, the rate of mis-selling of products is fairly high in China. For instance, life insurance plans are often sold as add-ons to larger wealth-management products that are designed by banks. Customers often receive minimal instruction on the insurance product, and in many cases do not even understand what it is. This trend has given rise to complaints about mis-sold products and poor customer service, leaving some customers suspicious of both banks and insurers.

For two industries based on trust, this is worrying to say the least. Yet the status quo that we see in China's bancassurance market is, to a large degree, self-perpetuating. Just as the proliferation of more-complex, targeted products is held back by banking staff's lack of product understanding and uneven customer service, demand is curbed by limited consumer awareness and lukewarm confidence in the products.

Yet here lies the opportunity. Bancassurers that possess both targeted product offerings and a clear way of explaining and marketing them will be able, in essence, to teach customers what they do not yet realize they need. Or in more formal terms, first movers in product innovation and in the development of comprehensive customer-support services will have an opportunity—possibly a golden opportunity—to influence long-term purchasing behavior and catalyze brand loyalty in a relatively nascent market.

Ultimately, bancassurers and bancassurance partnerships that can reposition themselves in a way that allows them both to differentiate and significantly upgrade their products and services will capture a larger share of customer wallet and get a head start on establishing true competitive advantage for the future.

The Way Forward: Integration and Exclusivity

If more-complex, sophisticated products are to be successful, they must be reliable—delivering to customers exactly what is promised. Making them this way will require more rigorous product-development processes as well as higher degrees of integration and exclusivity in relationships between insurers and banks. Indeed, the current lack of exclusivity goes a long way toward explaining today's status quo.

Just look at European bancassurance markets compared to the Chinese market. Europe is home to a diverse cast of cooperative models, none of which resemble China's many-to-many model. In fact, many European markets saw their penetration peak around 2000, at which point the engine of further growth had to become more tailored. Product offerings were widened, and exclusive partnerships between banks and insurers were forged. Obviously, this has not yet been the case in China.

Of course, exclusive partnerships are sustainable only if they benefit both sides. While many insurers in China have learned that the bank platform offers them quick access to a large customer base at reasonable initial cost, Chinese banks must realize—far more than they already have—that increasing their share of wallet and building customer loyalty also depends on the growth of their total financial-services offering. Insurance will remain a fast-growing sector in China's economy for years to come. But bancassurance premiums will grow at a corresponding pace only if penetration is not held back by a fee-driven, sub-par product and service offering. If bancassurance is to thrive and reach its promise in China, banks and insurers will have to achieve further integration, forging exclusive partnerships that are mutually beneficial and that steer the industry away from the current many-to-many model.

Regulatory Reform: A Transition Already Underway

Although wholly exclusive bancassurance partnerships have not yet appeared in China, the emergence of some integrated financial groups represents a step in the right direction. Most of this incipient cooperation has come about through regulatory reform created by the two relevant government bodies—the China Insurance Regulatory Commission (CIRC) and China Banking Regulatory Commission (CBRC).

In general, both agencies aim to foster healthy, stable growth of the insurance and banking sectors, as well as protect consumers from unfair and unsavory business practices. By developing a regulatory regime that promotes greater integration and exclusivity between banks and insurers, CIRC and CBRC will enable greater investment in product development and service quality while simultaneously allowing for reasonable profit margins. Bancassurance is already the biggest channel for insurance sales in China, and much is riding on its future success—both for industry participants and for consumers.

Thus far, the pace of reform has been gradual. Since the Chinese government first officially permitted banks to operate as multiple insurance agents in 2003—galvanizing the many-to-many distribution model—it has quickly yet cautiously introduced new policies that enable deeper integration between banks and insurers.

One of the standard approaches to integration is cross-shareholdings. In September 2006, CIRC first permitted insurance companies to invest in local commercial banks, setting in motion a wave of activity. Then, in January 2008, a draft regulation was circulated by CBRC that would grant banks permission to start insurance businesses by acquiring stakes in insurance companies. The practical details of exactly how this would work remained unclear at first, but later information provided details about a pilot program in which four Chinese banks would acquire stakes in existing insurance companies. The press subsequently reported on further decisions involving CIRC, CBRC, and the State Council, as well as on several anticipated deals involving the aforementioned pilot banks as well as other players. In late November 2009, CBRC finally issued the long-awaited rules governing commercial banks' investments into insurers. Nonetheless, banks have not yet been allowed to open their own insurance businesses, although government sources say that relevant policies are in the works.

Incremental regulatory reform of distribution channels and product types is underway as well in 2009. For example, CIRC has asked insurers to control volumes and adjust the types of product sold through banks. This stipulation is partly the result of some instances of misrepresentation of unit-linked products—as well as of the comparatively low embedded value of products currently sold through the bancassurance channel. In addition, CIRC now requires banks to set up an aptness assessment system for customers buying unit-linked insurance products. Such products must be sold in designated areas inside a banking outlet, and handled only by specialized salespeople. In an effort to avoid misinformation in product promotions, any cross-selling of unit-linked insurance products in banks' wealth management divisions is no longer allowed.

CIRC and industry bodies such as the China Insurance Industry Association have also put more emphasis on risk management recently, and seem to be committed to fostering healthier bancassurance economics overall, partly as a reaction to fierce price competition. Back in 2006, the China Insurance Industry Association first pioneered the development of a self-discipline agreement for bancassurance, which set ceilings on commission rates paid by insurers to banks, by type of product.

Successful Pathways to a Winning Bancassurance Model

The Opportunity

A move toward greater integration and exclusivity among banks and insurers is in line with good business practice as well as with regulatory agendas. We believe that China will soon undergo a transition period in which major players move strongly in this direction, leaving behind the currently dominant many-to-many model.

The exact shape that partnerships take will depend largely on the specific players involved. Each company's expansion strategy, organizational structure, risk appetite, and capital requirements will determine which type of arrangement is best. Take two established examples in Hong Kong. Standard Chartered has elected not to own an insurance company outright, instead forging a strategic partnership with Prudential, the U.K. insurer. The accord allows Standard Chartered to receive pure fee and commission income with minimal capital investment. HSBC, on the other hand, created its own insurance entity and a totally integrated line of insurance products, which are exclusive to HSBC. While this model provides HSBC with additional revenue streams, the bank has also had to make a significantly higher capital commitment.

Such structures can also work on a regional scale, or focus on a single product or product subgroup. For instance, an exclusive distribution partnership could be forged solely for several branches or regions within a much larger network or for a specific product type on a country-wide basis. A bank could also integrate a custom-designed insurance joint venture into its systems. In essence, the integration of insurance businesses into a banking sales channel offers up myriad opportunities for partnerships that can be tailored to each player's particular strategy.

A Win-Win Approach

Banks: What they stand to gain

Why should banks alter a system that pays them so handsomely in commissions? As we have alluded to, banks that establish exclusive partnerships with insurers will be better positioned to keep a larger share of their customers' wallets in the future. Furthermore, we believe that future growth in China's bancassurance sector will not come as easily as it has in the past, and that continued success will require more innovation. Banks, by providing better service to their customers and offering more targeted insurance products, can dramatically increase cross-selling potential and fee revenues, earning attractive margins from a whole new range of products. In addition, with overall penetration of insurance products in China still at a relatively low level, there is significant room for banks to participate in higher value-added parts of the insurance value chain without directly competing with incumbents.

Some international insurers have the experience and capabilities from several markets to make an integrated, exclusive bancassurance model work, particularly with respect to setup, product design, go-to-market approach, operations, back office and POS systems, and, of course, capital and risk management. This is a so-far widely untapped source of value for China's banks.

Insurers: What they stand to gain

For insurers, building more-exclusive, better-integrated relationships with banks represents far more than just a chance to capitalize further on China's strong growth in bancassurance premiums. The real opportunity is to solidify brand reputation and customer loyalty at a time when most consumers are still uncommitted, overall insurance penetration is still shallow, and competitor offerings are still limited. But success will require substantial investment both in capital and human resources. Insurers must therefore gain a larger slice of the pie than the current system affords them.

As we have mentioned, bank branch networks can provide very attractive market access to insurers. This is especially true in provinces where insurance penetration is low relative to the banking infrastructure. Foreign players, especially, tend to lag behind local players both in terms of sales networks and license coverage. Some foreign players have suffered market share losses during the recent rapid expansion in banassurance channels—growth that has disproportionately benefited local players given their larger geographic coverage. Joining forces with a local bank may also help insurers speed up the licensing process in new areas.

Different Models Work for Different Players

Of course, banks and insurers must choose the models that make the most sense given their specific resources and strategic objectives. We have observed four different models which, depending on the exact context, have proven to be successful across markets:

- exclusive distribution partnership
- joint venture
- financial holding company
- integrated line of business

Exclusive distribution partnership. In this model, the bank and insurance company agree to total exclusivity, either in one direction or both. This type of agreement allows both companies to broaden the spectrum of their offerings and leverage each other's brand reputations and expertise in product development and sales. It requires only as much initial investment—in setup costs for sales outlets, IT, training, etc.—as the partners need in order to launch their efforts at the same time.

This type of partnership can be reinforced by a cross-shareholding structure. However, since the bank earns only a distribution margin, insurers must offer banks incentives to sell a product that will complement—or potentially even compete with—other banking products. This model is ideal for banks that opt for a low capital commitment in their insurance offering, since relatively small initial investments are required. A wide variety of pilot programs are possible under this type of arrangement.

Ultimately, an exclusive distribution partnership fosters greater focus and cooperation between the bank and the insurer, and enables a more professionalized and effective sales force. The accord allows insurers to reach banks' existing customer bases as well as fully leverage banking sales channels going forward. In turn, the bank can utilize the insurer's expertise in product development and sales strategy. Also, the arrangement can be launched with a relatively short ramp-up period since limited operational integration is necessary. What's more, the partnership can be used as a viable long-term strategy if the contract length is sufficient and if the mutual commitment deepens.

In practice, exclusive distribution partnerships work best when banks and insurers coordinate their sales approach. The referral process can be tailored to suit capacity and needs, and can include solutions such as specialized call centers. In general, financial-services managers from the insurance side collaborate with bank branch agents to explain insurance products to customers alongside bank products.

Prudential's exclusive partnership with Standard Chartered in Hong Kong is a good example. Under the arrangement, which has been in place for more than a decade, Prudential assigns managers to Standard Chartered's branches. These managers offer insurance and financial-planning advice to customers, as well as provide training to the bank's staff on how to sell Prudential's products. The model has been so successful that the partnership has been expanded to many other Asian markets.

Joint venture. To form a joint venture, a bank and an insurer set up a separate legal entity to leverage the manufacturing capabilities of the insurer and the distribution capabilities of the bank. This type of accord typically requires a longer investment horizon than exclusive partnerships, and allows the two parties to share capital commitment—sometimes allowing one party to take full control in the future. The establishment of a revenue distribution mechanism through share percentage can give banks a degree of flexibility in adjusting commission fees.

One successful example of the joint-venture model in Asia is CIMB Aviva, forged by Aviva and CIMB Bank, the second-largest financial services provider in Malaysia. A key element of success for this venture is that Aviva shares its insurance expertise by transferring highly-experienced senior executives to the new entity, while CIMB offers its large branch network for exclusive bancassurance distribution.

Financial holding company. The financial holding company (FHC) model involves a single legal entity with separate insurance and banking subsidiaries, which may or may not be wholly owned. This structure allows the balancing of different financial-services business lines, with synergies, risk sharing, and capital management at the holding company level. The model offers a powerful response to heightened market competition, allowing rapid expansion through aggressive M&A and the flexibility to invest in or divest businesses. Exclusive and integrated partnerships between group companies are relatively easy to establish and customize. When executed well, the financial holding company model can keep productivity particularly high.

In Taiwan, most major financial institutions are organized as subsidiaries under an FHC. A prime example is Fubon FHC, which holds Taipei Fubon Bank, Fubon Insurance, and Fubon Life. By separating its companies, Fubon FHC is able to leverage synergies via the bancassurance model while still maintaining independent operation of each unit. This is an organizational feature that, in China's current regulatory environment, would represent a significant advantage.

Integrated line of business. In this model—based on internal organization rather than legal integration—the bank sets up a new line of business for insurance. This can be done organically or by acquisition, much in the same way a bank might set up any new line of business. This model provides maximum strategic and operational control to the bank, allowing it to look at insurance from the perspective of the full value chain—including both production margin and distribution margin. Internal competition is minimized and each business line focuses on its core competence in a way that is difficult to achieve through any other model. Also, aligning different business units under the same corporate business strategy, governance framework, and management system can enhance synergies both on the cost and revenue sides.

What is more, this model maximizes corporate branding opportunities. The incentives to sell insurance are greater than in a distribution agreement, and the bank can benefit from taking a comprehensive "lifetime value" view of its customers.

One of the best examples is HSBC's success in Hong Kong, where it has developed an in-house bancassurance business and set up HSBC Life and HSBC Insurance. HSBC has almost fully penetrated its deposit base in selling insurance, allowing it to gain market share rapidly. It is now the leading insurer in Hong Kong in terms of new business generated. The integrated line of business model allows HSBC to maximize its share of the customer wallet through a targeted, highly-differentiated product line. On the operations side, HSBC in Hong Kong does nothing but bancassurance and has no sales channels with tied agents—eliminating any conflicts of interest.

Finally, it is worth noting that of course not all players are suited for the integrated line of business model, or even the financial holding company model. While the above examples are widely recognized as successful, many other attempts have been less so. Some of these initiatives have already led to divestitures, and others are still in the process of splitting up, most notably in Europe. While the root causes of each case may be different, there is a wide consensus that management capabilities for banks and insurance companies differ markedly, and that combining both in one corporation can lead to considerable challenges and complexities.

The 10 Building Blocks of a Successful Bancassurance Model

Succeeding at bancassurance in China involves more than just choosing the optimal model. It also involves excelling at the everyday nuts and bolts of the business. In our view, there are ten critical building blocks to success that require flawless execution. Let's explore them. (See Exhibit 4.)

Develop products jointly. Of course, there are many ways to combine expertise and talent from both sides of the partnership to create compelling bancassurance products. In our experience, a genuinely joint effort between the bank and the insurer works best.

For example, a sound joint effort might start with monthly meetings in which marketing managers from the bank's key product lines—transaction banking, credit, savings and investment, and insurance, for example—gather with representatives of the insurance company to discuss new product ideas. Then, in quarterly strategy committees, insurance product-line managers could present their ideas to bank managers, who could then decide which ideas to develop further. From that point on, joint product development teams could work on the selected ideas. Meeting structures and formats can vary, of course. But the goal is to set up lasting forums that foster the cross-pollination of ideas among representatives of both sides of the partnership.

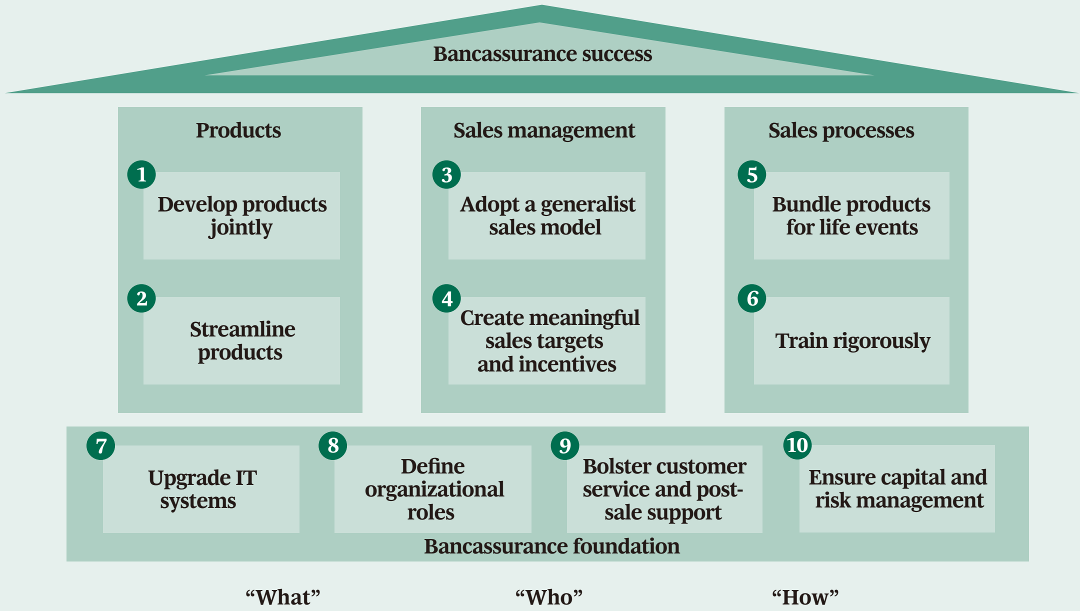
Streamline products. Given the limited offerings available in China today, bancassurers will have multifarious ways to differentiate themselves. For the mass market, however, strategies that concentrate on developing a line of simple, highly-targeted products within several product segments will likely be met with the most success.

Royal Bank of Scotland's strategy in the United Kingdom is a good example. RBS offers only 10 products via its bancassurance platform—three in life insurance, and seven in non-life (property and motor insurance). This focused, streamlined approach allows RBS to optimize product design and enhance service quality.

Affluent customer segments have more diverse and sophisticated needs that require more-complex products and hence call for sales staff with higher qualifications and a more individualized sales process. Larger contract values can justify the resulting higher cost base and generate some very attractive returns.

Adopt a generalist sales model. Besides offering the right products, establishing the right sales approach can make a tremendous difference. There are typically three basic sales models, defined by how they allocate the three steps of a sales transaction: need recognition, client advice, and contract closure.

Exhibit 4. There Are 10 Building Blocks to a Successful Bancassurance Model



Source: BCG experience.

In the "generalist" model, all three steps are in the hands of bank staff people in the branch. In the "referral" model, bank staff directs customers to in-branch insurance agents after identifying a customer need. The third, "specialist" model requires joint need-recognition by bank staff and by an in-branch insurance specialist, who then oversees completion of the sale.

All three models are workable. Yet our research indicates that the generalist approach, in which bank staff is trained to sell a variety of insurance products in addition to bank products, tends to be the most effective.

Create meaningful sales targets and incentives. Meaningful targets and incentives are critical to building an effective sales force. Although various strategies can be viable, our experience working with industry participants demonstrates that the best way to boost productivity usually involves some combination of variable compensation for agents and special rewards for team success. Variable compensation structures can be used to create additional sales incentives, building from a base commission. Special rewards, on the other hand, might focus on group effort, thus encouraging cooperation. The combination of these elements is crucial for creating incentives that will motivate every bank staffer and insurance agent to attain aggressive sales goals.

Bundle products for life events. Offering product combinations linked to specific life events can lift bancassurance sales significantly. Project work carried out by The Boston Consulting Group in Europe has shown that conversion rates for event-driven product combinations—which can relate to the customer's first job, marriage, relocation, and retirement, for example—can reach between 15 and 25 percent, compared with 2 to 3 percent for direct marketing and 3 to 10 percent for general product offerings with follow-up calls.

Train rigorously. Regular, comprehensive training is, naturally, a vital part of building a successful bancassurance business. Training is particularly important when the integration of banks and insurers begins to deepen. The level of coaching both on the details of insurance products and on sales processes should be tailored to the degree of experience of each trainee.

Upgrade IT systems. The integration of front- and back-office IT systems is another important element of an effective bancassurance strategy. The front-office system should feature guidelines for dialogue with customers and for efficient data entry. The back-office system must have high processing efficiency featuring fully automatic and paperless data exchange, online underwriting, and common database management between the bank and the insurer.

Define organizational roles. The organization of any bancassurance partnership will depend in part on existing managerial structures. Within this framework, a hierarchy of roles should be clearly defined for agenda setting, coordination, and execution. Even more important, the bank and insurer should each have parallel hierarchies in order to balance priorities and ensure the best possible integration at each operational level.

Bolster customer service and post-sale support. Top-flight customer service must be driven jointly by the bank and the insurer. This requires the coordinated assignment of specific duties to bank staff, in-branch insurance staff, out-of-branch insurance agents assigned to a given branch, and call centers dedicated to post-sale support. Selective use of third-party administrators can be considered, particularly when it comes to lines of business that generate comparatively complex claims. Obviously, claims processes must be carefully managed, as failure to do so has led to some strategic readjustments for bancassurers in the past.

Ensure capital and risk management. A bancassurance business can never simply be a self-financing "add-on" for the bank. Underwriting and assuming insurance risk, especially over the long term, requires additional capital upfront and ongoing risk management. The latter often includes the transfer of certain risks to a reinsurer.

Regarding capital management, when bancassurance partnerships are exclusive and stable, the business can grow rapidly. In such cases, insurance-driven solvency capital requirements will increase just as rapidly for the bancassurer, and may strain accounting profitability as well. Breaking even on an insurance investment can therefore appear to take longer for a bank than originally anticipated by senior management and investors. Also, insurance capital requirements prescribed by regulatory authorities can be higher or at least different from those calculated by the bank's in-house models, requiring the bank to make necessary adjustments.

The obvious solutions to capital duress involve issuing debt or equity—or using reinsurance since the transfer of premiums and risk to a reinsurer typically results in lowered solvency capital requirements for the bancassurer. All of these options secure or free up funds that can be reinvested elsewhere in banking or used to grow the bancassurance business even faster.

Aside from its uses in standard risk and capital management, reinsurance can also help by offering tailored core and auxiliary service across the bancassurance value chain—including, in many cases, cooperation on product design, underwriting manuals, standard protocols, training, provision of IT systems, and the like.

A Call to Action

If the current status quo in China's bancassurance industry remains unchanged for much longer, sales will hit a wall of sorts. The prevalent many-to-many model will hamper future development. Already, the demand for sophisticated insurance products—stoked by the force and speed of China's macroeconomic evolution—is being clogged by the impasse between banks and insurers. Cutthroat and mono-directional price competition will not foster innovation or raise customer awareness. Partners that integrate, become more exclusive, and invest in the quality of their products and services *now* will have a golden opportunity to establish competitive advantage.

Indeed, banks that develop exclusive partnerships with insurers will be able to better meet their customers' current and future needs, increase cross-selling and fee revenues, and perhaps add a potentially attractive margin from the life insurance business itself. For insurers, building such relationships will allow them not only to maintain the premium growth we have seen so far, but also to showcase and solidify their brands while customer consciousness and loyalty is still underdeveloped, while the geographic reach of most bancassurers is still limited, and while most competitor product offerings are still rudimentary.

Players must choose among the four basic models of more-exclusive and integrated collaboration between insurers and banks. The size and capital base of the players, the degree of control that each comes away with, and the overall economics of each deal will strongly influence their choice of partners. To be sure, there will likely be many regional and product-specific customizations of these basic models. The devil, as always, will be in the details of execution. Companies that both make the right strategic choices and that excel in swift implementation of a more advanced and customer centric bancassurance model will find themselves wielding considerable power in China's opportunity-rich financial services market.

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The Boston Consulting Group's (BCG) offices in China and Swiss Re's offices in China have worked together over the last few months to produce this White Paper. If you are interested in obtaining additional information, please contact BCG's or Swiss Re's Beijing office.

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The Boston Consulting Group (BCG) is a global management consulting firm and the world's leading advisor on business strategy. We partner with clients in all sectors and regions to identify their highest value opportunities, address their most critical challenges, and transform their businesses. Our customized approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organization. This ensures that our clients achieve sustainable competitive advantage, build more capable organizations, and secure lasting results. Founded in 1963, BCG is a private company with 66 offices in 38 countries. For more information, please visit www.bcg.com.

Founded in 1863 in Zurich, Switzerland, Swiss Re is renowned for its commitment to excellence in security, solutions and service and has a proud 146-year history of delivering for customers. Swiss Re offers traditional reinsurance products and related services for property and casualty, as well as the life and health business. These are complemented by insurance-based corporate finance solutions and supplementary services for comprehensive risk management.

A public company, Swiss Re shares are listed on the main board of the SWX Swiss Exchange and traded on virt-x under the symbol "RUKN". Swiss Re is rated "A+" by Standard & Poor's, "A1" by Moody's and "A" by A.M. Best.

Having established its first physical operations in the region in 1956, the company has offices in a number of Asian countries, including Japan, Korea, Singapore, China, India and Australia. The company's Asia Division headquarters is in Hong Kong.

Swiss Re was among the first foreign reinsurers to enter China after the country gradually opened its insurance market. Swiss Re set up representative offices in Beijing and Shanghai in 1996 and 1997 respectively, and opened its Beijing branch on December 19, 2003 to conduct life and non-life business throughout the country.

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