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THE EFFECT OF THE GRAMM-LEACH-BLILEY ACT ON THE BANCASSURANCE MODEL IN THE UNITED STATES

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ABSTRACT

I will discuss the Gramm-Leach-Bliley Act and its effect on the bancassurance model in the United States. This legislation, passed in 1999, repealed the Glass-Steagall Act, a Depression-era law that created barriers between various types of financial institutions. The Gramm-Leach-Bliley Act broke down these barriers, and commercial banks, investment banks, and insurers were free to cross over into other financial sectors. This freedom led many to believe that there would be a boom in the use of the bancassurance model, a combination of banking and insurance that had experienced popularity and success in Europe. I will outline the details of the Gramm-Leach-Bliley Act, define and characterize the bancassurance model, describe the expectations for the Act's effects, depict the actual effects, and explain the reason for the discrepancy between the two.

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Chapter 1

Introduction

On June 16, 1933, President Franklin Roosevelt signed the Glass-Steagall Act into law. Aside from establishing the Federal Deposit Insurance Corporation (FDIC), the act separated financial institutions like commercial banks, investment banks, and insurance companies, and prohibited their merger. For decades, leaders of American financial institutions wondered what would happen if the barriers separating them were removed. In 1999, with the passage of the Gramm-Leach-Bliley Act, they stood to find out. The law removed the restrictions of the Glass-Steagall Act, leading politicians and experts to predict a massive wave of mergers and acquisitions. They expected that this convergence would lead to the widespread adoption of the bancassurance model, the combination of banking and insurance services that had become so successful in Europe. Unencumbered by Depression-era restrictions, financial institutions could apply this model and usher in a new era of financial supermarkets, or “one-stop-shops.”

The following thesis will discuss the Gramm-Leach-Bliley Act, also known as the Financial Service Modernization Act of 1999, the bancassurance model, the expectations of the effects of the new legislation on the bancassurance model, the actual effects of the law on the bancassurance model, and the reasons for the unfulfilled expectations.

Chapter 2

The Gramm-Leach Bliley Act (Financial Services Modernization Act of 1999)

The Gramm-Leach Bliley Act, or the Financial Services Modernization Act of 1999, was enacted by the 106th United States Congress. The act permitted the consolidation of various financial institutions like commercial banks, investment banks, securities firms, and insurance companies. This type of consolidation had been prohibited by the Glass-Steagall Act of 1933, which created barriers between financial institutions in the wake of a commercial-banking crisis from January to March of 1933. The Gramm-Leach-Bliley Act officially broke down these barriers, although they had been relaxed years earlier. It also repealed the Bank Holding Company Act of 1956, which prohibited bank holding companies from engaging in insurance-related activities. After the passage of the Gramm-Leach-Bliley Act, banks were free to both acquire insurers and sell their products, and insurers could do the same to banks. However, the law was not a sudden change; financial services regulations had been loosened for years.

In December 1986, the Federal Reserve Board reinterpreted the Glass-Steagall Act and decided that the law prohibiting banks from being "engaged principally" in securities did not mean that they could not be engaged at all. This reinterpretation led them to allow commercial banks to earn up to 5% of gross revenue from investment banking. The following year, the Federal Reserve Board overcame opposition from Chairman Paul Volcker and voted 3-2 to ease Glass-Steagall regulations (Yang, 1987).

After years of gradually loosening restrictions, the Federal Reserve Board rendered Glass-Steagall's restrictions on commercial and investment banks nearly obsolete, as it introduced a new 25% limit for commercial banks' holdings in securities, a limit that virtually any bank could stay under. However, insurance underwriting was still off-limits to banks under the Glass-Steagall Act.

The regulatory policy of separating banking and insurance was thrown into chaos in April of 1998, however, when Sandy Weill, chairman and CEO of Travelers, and John Reed, chairman and CEO of Citicorp, announced a $70 billion stock swap that would engage their respective companies in the largest corporate merger in history and create Citigroup. The only problem was the merger was illegal under the Glass-Steagall Act. To address this illegality, Citigroup was given a two-year grace period to continue operations in the hopes that Glass-Steagall would be repealed in that time frame. If not, Citigroup would be forced to divest its insurance arm (O'Brien &Treaster, 1998).

Essentially, Citigroup was given two years to see if it could change the law. It was a classic test case of business versus government. Could money buy the law? Lobbyists from the finance, insurance, and real estate industries were willing to bet yes, as they spent over $200 million on lobbying and made over $150 million in political donations during the 1997-1998 election cycle, with campaign contributions specifically aimed at members of Congressional committees with jurisdiction over financial services legislation (Frontline, *PBS*). Their efforts paid off. On November 4, 1999, the House and Senate approved a final version of the Gramm-Leach-Bliley Act, and, about a week later, President Bill Clinton signed it into law.

Many expected the law to immediately and drastically alter the state of the financial services industry. Backers of Gramm-Leach-Bliley imagined a new industry environment where colossal takeovers and financial supermarkets were the norm. Most experts predicted a torrent of banking mergers and acquisitions, and, as banks had been lobbying for the repeal of the Glass-Steagall Act for years, most assumed insurers would be quickly snatched up by banks (Panko, 2005).

More recently, the Gramm-Leach-Bliley Act has been the subject of rancorous political debate. President Barack Obama has gone on record blaming the bill for the 2007 subprime mortgage financial crisis. During his presidential campaign against Senator John McCain in 2008, Obama said, “Senator McCain has fought time and time again against the common sense rules of the road that could have prevented this crisis. His economic plan was written by Phil Gramm, the architect in the United States Senate of the deregulatory steps that helped cause this mess” (Cable News Network, *Finance Wire*, 2008). Obama was even more specifically critical of the Gramm-Leach-Bliley Act earlier in his campaign. “By the time the Glass-Steagall Act was repealed in 1999, the $300 million lobbying effort that drove deregulation was more about facilitating mergers than creating an efficient regulatory framework,” he said. “The regulatory environment failed to keep pace. When subprime mortgage lending took a reckless and unsustainable turn, a patchwork of regulators were unable or unwilling to protect the American people” (Hopkins, 2008). Ironically, McCain, along with Senator Maria Cantwell, introduced the Banking Integrity Act of 2009, which would essentially reinstate Glass-Steagall restrictions.

Most Republicans, many economists, and former President Clinton have defended the Gramm-Leach-Bliley Act against claims that it brought about the 2008-2009 financial crisis. They argue that investment banks were already allowed to invest in the assets that caused the crisis before 1999. Moreover, they claim that the Gramm-Leach-Bliley Act actually alleviated negative consequences of the financial crisis. “‘I don't see that signing that bill had anything to do with the current crisis,’” Clinton says. “‘Indeed, one of the things that has helped stabilize the current situation as much as it has is the purchase of Merrill Lynch by Bank of America, which was much smoother than it would have been if I hadn't signed that bill'" (Bill v. Barack, 2008). Defenders of the Gramm-Leach-Bliley Act also like to point out that the bill passed in the Senate with an overwhelming 90-8 majority that included 38 Democrats, one of whom was Vice President Joe Biden. The bill passed in the House of Representatives with a vote of 362-57. The vote summaries, available in the appendix, illustrate the widespread support for the legislation at the time of its passage.

Chapter 3

Bancassurance

Many thought that the Gramm-Leach-Bliley Act would bring a new business model to the financial sector: the bancassurance model. At its crux, bancassurance is simply the union of banking and insurance activities. However, experts in the study of this model have offered various definitions of the term with subtle but important differences. These definitions fall into several categories.

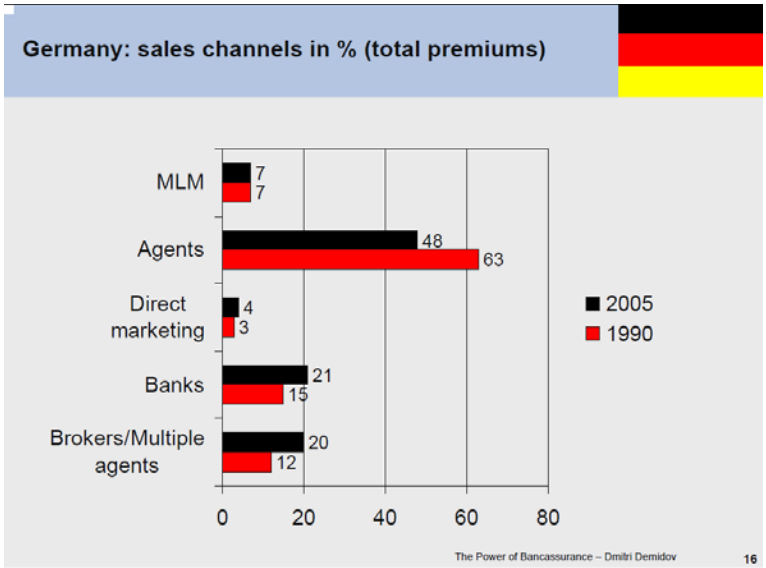
The first category focuses on distribution and cross-selling. Hoschka, in his *Bancassurance in Europe*, states that “This trend towards bancassurance or Allfinanz refers primarily to banks entering the insurance sector by offering insurance products to their retail customers” (Hoschka, 1994, p. 1). H. Huizinga, a former executive director for ING, a former bancassurance stalwart, puts it in even simpler terms – “Allfinanz (or bancassurance) is distribution” (Genetay, 1998, p. 8).

Others who have attempted to define bancassurance focus instead on the integration of banking and insurance activities. Elkington asserts that “Bancassurance is basically the provision of and selling of banking and insurance products by the same organization under the same roof” (Elkington, 1993, p. 2). Skipper offers a similar opinion, but delineates specific roles for each arm: “Bancassurance and Allfinanz describe arrangements... between banks and insurers for the sale of insurance through banks, wherein insurers are primarily responsible for product manufacturing (production) and banks are primarily responsible for distribution” (Skipper, 1997, p. 167).

Perhaps the best definition of bancassurance, however, is the broadest, as the concept itself takes many forms and differs in meaning to various individuals and institutions. Swiss Re provides a definition whose breadth reflects the reality of the nebulous nature of the bancassurance concept: “As a rule, bancassurance can be described as a strategy adopted by banks or insurance companies aiming to operate the financial services market in a more or less integrated manner. In practice, the term ‘bancassurance’ is consistently used to describe a new strategic orientation of financial institutions in private customer business” (Genetay, 1998, p. 9).

While the bancassurance model has been experimented with across the globe, the sites of its greatest popularity and success have traditionally been in Europe, especially in Germany, France, Italy, and Spain. The earliest manifestations of bancassurance in Europe arose in Germany at the beginning of the 20th century, when co-operative banks Raffeisen and Volkensbanks entered into a marketing agreement and created the insurer called R&V Lebensversicherung. Although the bancassurance model has made only modest gains in Germany, the innovations there have had a significant impact on banking and insurance industries in neighboring countries. France, for example, has fully embraced the bancassurance concept. The following figure, from a 2006 presentation at the Second International Conference on Life Insurance by Dmitri Demidov, illustrates the percentage of total premiums earned through banks and other sales channels. Figures 3-1 through 3-5 are taken from the same presentation.

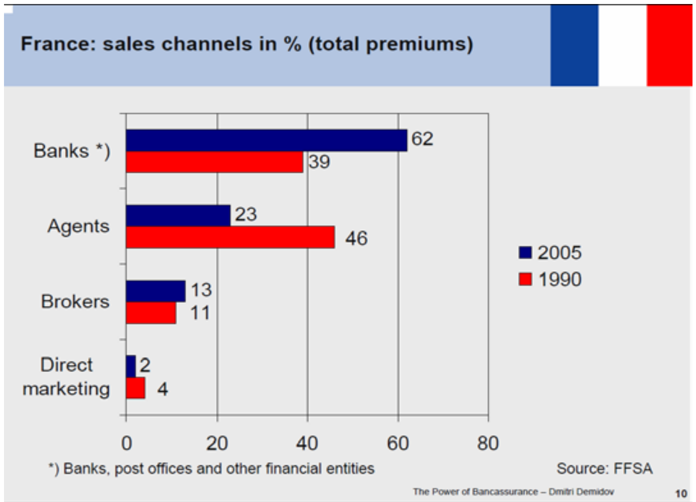
Figure 3-1: Germany, sales channels in % (total premiums)



Source: Demidov, 2006

The German influence is especially clear in the Alsace region of France, which is near the German border. Crédit Mutuel, a perceived follower of Raffeisen and Volkensbanks, boasts a heavy presence in the region (Genetay, 1998, p. 73). France, however, proved to offer a much more receptive environment to bancassurers, for several reasons. First, France's insurance industry was dreadfully weak and lacking competition. This left the door wide open for able competitors to enter the market, and banks, with their superior distribution channels, pounced on the opportunity. The French government has also deliberately embraced the model, as it has induced and encouraged several bank-insurer connections and offered favorable tax treatment of certain life insurance products. This tax treatment allowed banks to offer simple, tax-advantaged endowment products through their own life insurance companies (Skipper, 1997, p. 167). These savings products, called "bons de capitalisation," are very attractive to customers and led banks to increase their share of the life insurance market by 60% from 1984 to 1988 (*The Economist*, 1990). Selling these products helped Predica, the insurance arm of Crédit Agricole bank, become the second largest life insurer in France less than 10 years after entering the market (Skipper, 1997, p. 167).

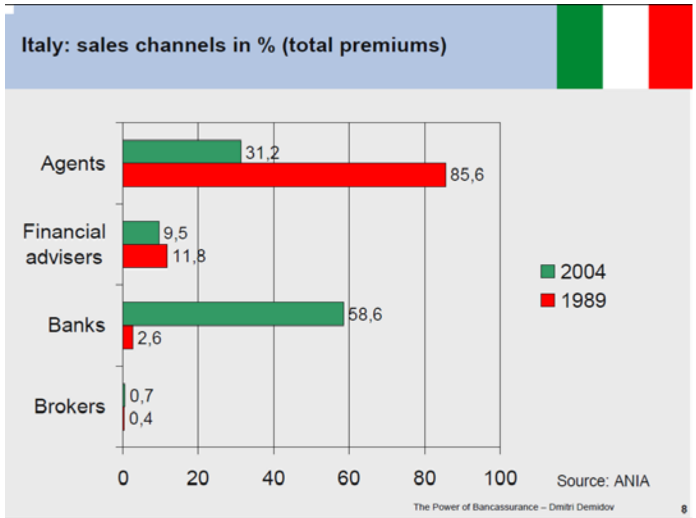
Figure 3-2: France, sales channels in % (total premiums)



Source: Demidov, 2006

In southern Europe, Italy and Spain in particular, the bancassurance model has also been utilized with some success. Bancassurance in Italy has shown tremendous growth since 1990, following the lifting of regulatory restrictions. Insurers, eager to seek alternate distribution channels after years of a dominant force of agents naming its own commissions, quickly sought out partnerships with banks. This strategy made distribution of insurance products both more effective and efficient.

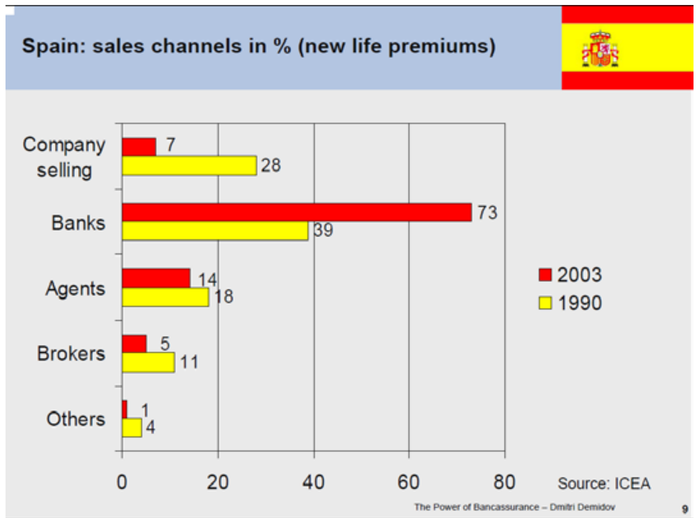
Figure 3-3: Italy, sales channels in % (total premiums)



Source: Demidov, 2006

While bancassurance is relatively new in Italy, Spanish banks have historically owned insurers and distributed insurance products. However, the model received a boost in the early 1990s when restrictions were loosened, just as they were in Italy. In both countries, bancassurers benefited from the inherent cultural sentiment towards banks. "'In Spain customers have a lot of confidence in their banks and are more susceptible to buying different products from their banks, while in other countries clients trust brokers,' says Tomás Muniesa Arantegui, chief executive of CaiFor. The same is true of Italy" (*The Economist*, 2003).

3-4: Spain, sales channels in % (new life premiums)



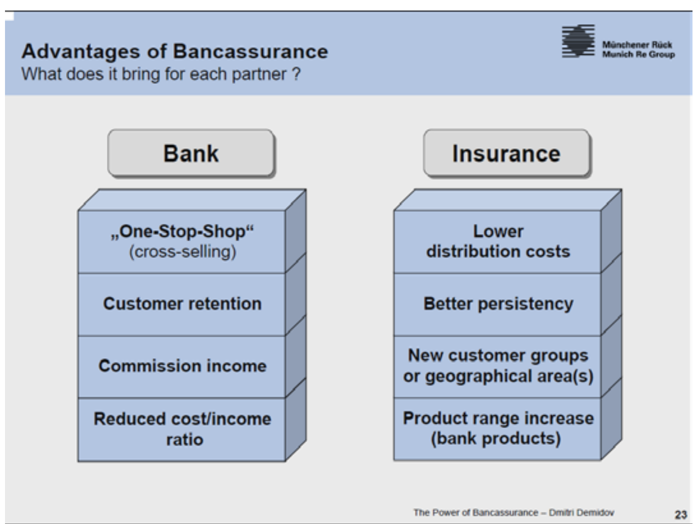
Source: Demidov, 2006

In the United States, the passing of the Gramm-Leach-Bliley Act was expected to bring about the advent of a similar increase in the use of the bancassurance model. More recently, however, the bancassurance model has experienced some setbacks both in Europe and North America. These setbacks will be discussed in greater detail later.

A primary reason for bancassurance's success in Europe and the expectation that this success would be duplicated in the United States was the perceived array of benefits of such a model. For the marriage of banks and insurers to work, there must exist tangible advantages to each party. By pairing with insurers, banks theoretically reap a bevy of benefits. First, they are able to construct a financial services supermarket, through which customers would be able to manage accounts, invest in securities, and purchase insurance. This "one-stop-shop" arrangement allows the bancassurer to utilize economies of scopeand to benefit from cost-efficiencies created by cross-selling. The bank also benefits from the bancassurance model by retaining customers who make more than one purchase, earning commission income, and decreasing the cost-to-income ratio.

The insurer, theoretically, also gains from the joint arrangement. Most importantly, as Huizinga stated so simply, the insurer improves distribution. By selling insurance in banks, where customers are already creating and managing their financial plans, insurers can reach far more customers, oftentimes in untouched geographical areas or market segments. Aside from increasing distribution, insurers can also lower the costs associated with it. For example, the increase in using the bancassurance model in Italy allowed insurers to decrease the commissions costs they were incurring by using a distribution strategy dominated by agents. Bancassurance also provides insurers with better persistency and gives them the ability to attract new customers with enticing savings products.

Figure 3-5: Advantages of Bancassurance for Banks and Insurers



Source: Demidov, 2006

Another major advantage to the bancassurance model is a result of diversification. Bancassurers, in theory, are less susceptible to risk. While the expected return of a diversified portfolio is equal to the weighted return of its individual investments, its volatility is diminished.

Ironically, it is the same idea of decreasing volatility through pooling that drives insurance. By engaging in both banking and insurance activities, firms are effectively hedging. Banks generally have short-term investment time frames, while insurers have long-term prospects. This difference supposedly leads to a smoothing out of earnings for bancassurers; banks do well when interest rates are low, and insurers do well when interest rates are high (Reguly, 2009). This idea of safety through diversification hypothetically makes bancassurers very attractive to investors.

Chapter 4

Expectations

For years, industry experts, banks, and insurers took notice of the supposed benefits of the bancassurance model. After the Gramm-Leach-Bliley Act was passed, many expected the lifted restrictions to revolutionize the financial services industry. This lofty expectation was reflected in the very title of the legislation. The bill, sponsored by Senators Phil Gramm, Jim Leach, and Thomas Bliley, was officially called the Financial Services Modernization Act of 1999.

One reason for the expectation that the Gramm-Leach-Bliley Act would revolutionize, or at least modernize the financial services industry, was the set of circumstances that led to its enactment. The Citicorp-Travelers merger created a new type of American firm; Citigroup was truly a “one-stop-shop” for financial services. Because the merger was the impetus for the passage of the Gramm-Leach-Bliley Act, many assumed that similar mergers or acquisitions between banks and insurers, sometimes called convergence, would become the norm and create a market dominated by colossal financial services conglomerates. “‘The Citigroup model is what business organizations will choose because that's law,’” Paul Pilecki, a lawyer who counsels banks on regulations, planning, and acquisitions, said in 2000. “‘Banking organizations won't be able to establish insurance subsidiaries, so the holding-company model will be used. Through its retail systems, it will attempt to deliver banking, insurance and securities products that the organization develops. That's what the law permits’” (Panko, April 2000).

Pilecki was not alone, however. Many experts predicted that, without the Glass-Steagall restrictions that distinguished the American financial services market from Europe’s, the United States would follow the European example of embracing bancassurance through massive acquisitions and mergers. "'It will be more like five years when you'll see a few more big, successful Citigroup types,'" said Robert Arning, former national industry director for KPMG's banking practice, in 2001 (Panko, September 2001). Chris Swift, Arning's former counterpart as national industry director for KPMG LLP's insurance practice added, "'We're probably close to 10 years away' from so many deals occurring that people will no longer distinguish between banks and insurers" (Panko, 2001). Matt Riebel, former president of Nationwide Financial Institutions Distributors Agencies Inc., was equally confident in Gramm-Leach-Bliley's effect on the industry, asserting that "eventually there will only be financial services companies, and people won't be able to tell whether they had been insurance companies or banks" (Panko, 2001).

The supposed benefits of the bancassurance model and the circumstances surrounding the passage of the Gramm-Leach-Bliley Act were major reasons for the soaring expectations for the bill's effects, but the economic environment of the time also provided the setting for a perfect storm of eager anticipation. The United States economy, buoyed by the Internet boom, had experienced an incredible four-year run prior to 1999, as business spending on equipment, adjusted for inflation, increased 60%, and the stock market rose a remarkable 160% (Mandel, 1999). This nearly unprecedented rate of growth, coupled with the technological innovations that made information the new key product, led many to speculate that we were witnessing the advent of a "new economy" (Petzinger, 1999). President Clinton seemed to embrace this idea as a justification for the passage of the Gramm-Leach-Bliley Act. He argued that the old, restrictive Glass-Steagall Act was "no longer appropriate to the economy in which we live. It worked pretty well for the industrial economy... But the world is very different" (Frank, 2010). Thus, the economic successes of the 1990s were a major contributor to the lofty expectations for Gramm-Leach-Bliley Act's effects.

A prominent aspect of the perceived "new economy" was the sudden increase in mergers and acquisitions. According to Thomson Financial Securities Data, a Newark-based markets research firm, there were $3.4 trillion in deals announced worldwide in 1999, topping the record $2.5 trillion in the previous year and obliterating the $464 billion in deals done worldwide in 1990. In the United States, there were $1.75 trillion in deals announced in 1999, compared with $1.6 trillion in 1998 and $195 billion in 1990, according to Thomson Financial (Sugawara, 1999). This idea of the "new economy" and the widespread consolidation that it accompanied merely promulgated the notion that the enactment of the Gramm-Leach-Bliley Act would create convergence in the financial services sector and promote the bancassurance model. Overall, the expectation was that the new law would revolutionize the financial services industry, and this sentiment was advanced by President Clinton. "The Gramm-Leach-Bliley Act makes the most important legislative changes to the structure of the U.S. financial system since the 1930s," he said in his official statement on the passage of the bill. "Financial services firms will be authorized to conduct a wide range of financial activities, allowing them freedom to innovate in the new economy… The Gramm-Leach-Bliley Act is a major achievement that will benefit American consumers, communities, and businesses of all sizes" (Clinton, 1999).

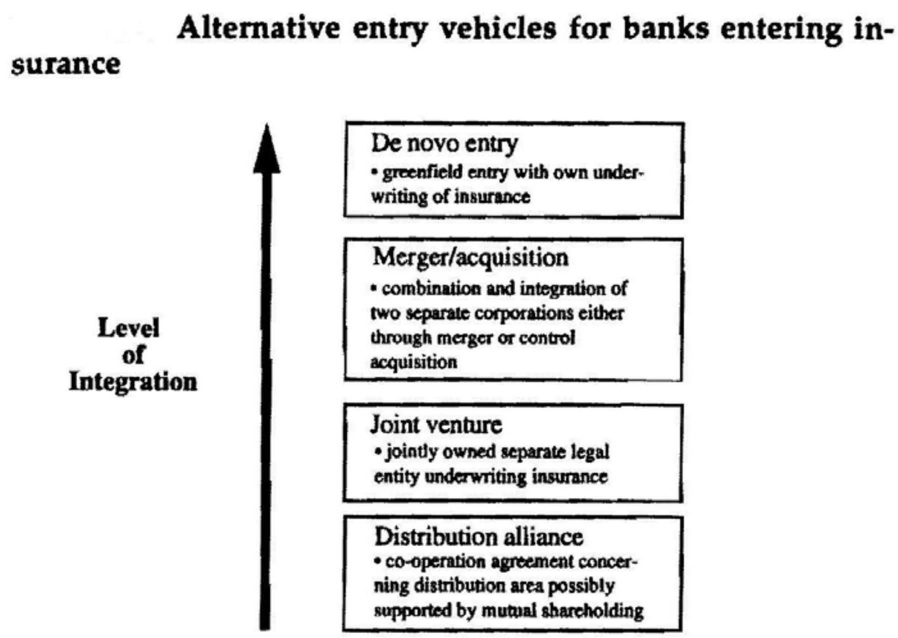
Chapter 5

Effects

President Clinton's statement reflected an industry-wide consensus of excitement and expectations. But what did the Gramm-Leach-Bliley Act actually accomplish? At first glance, the results were overwhelmingly disappointing. The predictions of an industry revolution, weekly mergers and acquisitions, and a totally integrated financial services market full of one-stop-shops culminated in a spectacular anti-climax. The anticipated wave of mergers, acquisitions, and formations of holding companies simply never materialized. In fact, by July 1, 2009, there were fewer than 600 financial holding companies authorized by the Federal Reserve (Tatom, 2009). As expected, there were a few large mergers, such as JP Morgan joining Chase, and acquisitions, like MetLife acquiring Grand Bank NA of Kingston, NJ. However, most other insurers and banks elected not to pursue these opportunities, for reasons to be discussed later.

Although the Gramm-Leach-Bliley Act did not bring about the anticipated bancassurance boom through mergers and acquisitions, it did promote the model in more subtle ways. Mergers and acquisitions only constitute one method for entry to bancassurance. Because of the momentous Citicorp-Travelers merger that forced the passage of the Gramm-Leach-Bliley Act in the first place, most experts assumed similarly colossal deals would be the norm; they assumed the effects would mirror the cause. They ignored, however, the various ways that banks could enter insurance and insurers could enter banking. Mergers and acquisitions, while certainly the most attention-grabbing of entry vehicles, were simply not the most profitable or practicable. Instead, some banks and insurers opted for alternative entry vehicles like de novo entry, joint venture, and distribution alliance. The level of integration that each entry vehicle entails is indicated in the figure below. De novo entry brings about the highest level of integration, followed by merger or acquisition, joint venture, and distribution alliance, respectively.

Figure 5-1: Alternative Entry Vehicles for Banks Entering Insurance

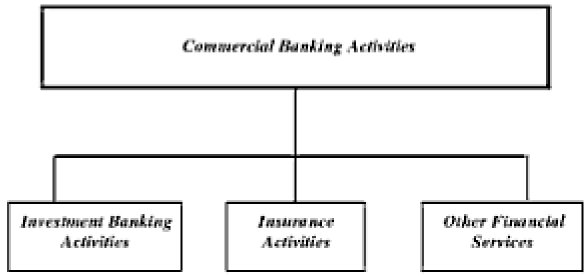


Source: Hoschka, 1994, p. 59

De novo entry entails the formation of a new company altogether. This strategy is usually considered impossible for entering retail financial services because building up a customer base is so time-consuming. In the case of banks entering into insurance, however, this method of entry can theoretically work because the banks already possess a customer base, the most difficult asset to create from scratch (Hoschka, 1994, pp. 61-62). As compared to mergers and acquisitions, de novo entry is an attractive alternative because of the superior level of control and high degree of integration. It has been successfully employed in Europe by TSB in England, Crédit Agricole in France, and Deutsche Bank in Germany. However, due to its high startup costs and relatively low returns, de novo entry has not been widely used by US banks as a means to enter into insurance.

The advantages of de novo entry have not been lost on the US insurance industry however. Between 1998 and 2005, more than 15 insurance companies set up retail banks, amassing more than $28 billion in assets, according to the Office of Thrift Supervision, which issues thrift licenses (Anand, 2005). Most notably, State Farm, since winning government approval to charter a federal thrift in November 1998, has been building what threatens to become a 16,000-branch financial supermarket (Harrison, 1998). State Farm Bank, with more than 1.9 million accounts at the end of 2008, is a prototypical example of successful de novo entry; State Farm essentially created one of the largest banks in the United States from scratch (State Farm Insurance Companies, *Datamonitor*, 2009). Other insurers like MetLife Inc., Principal Financial Group Inc., and Allstate Corp. have joined State Farm in the banking sector. Both State Farm Bank and MetLife Bank rank among the 75 largest banks in the United States, a remarkable feat for such a short time frame. Banking analysts agree that such an impressive rate of growth would be impossible for traditional banks and is likely attributable to the insurers' preexisting customer bases (Anand, 2005). Figure 5-2 illustrates the organizational structure of a bancassurer (originally a commercial bank) that has used the de novo entry vehicle.

Figure 5-2:
Financial Services Integration via Bank Ownership

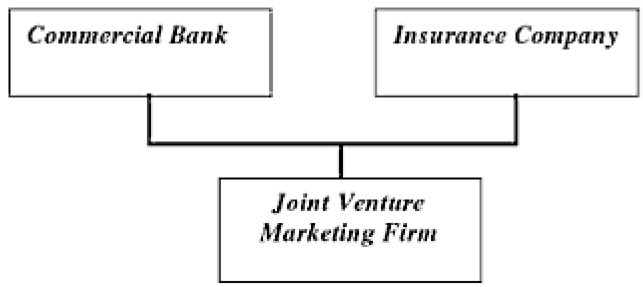


Source: Skipper, OECD, 2001

Another option for prospective bancassurers was to enter into a joint venture with a bank or insurer and set up a jointly owned entity usually offering insurance products to the bank's customers. This entry vehicle is similar, in many ways, to a distribution alliance. For example, an alliance of two firms with an ancillary, defined organizational unit could approach resembling a joint venture (Hoschka,1994, p. 89). This similarity has actually limited the frequency of the utilization of this entry vehicle in the United States, as entering into a distribution alliance is both easier and cheaper. Prospective bancassurers can reap many of the benefits of a joint venture by instead entering into a distribution alliance, thereby bypassing transactional and organizational hurdles and maintaining a higher level of autonomy. This alternative is one reason joint ventures have not been utilized heavily by banks and insurers in the United States. They have been successfully employed in Europe, however. Royal Bank of Scotland and Scottish Equitable, Commerzbank and Deutsche Beamtenversicherung in Germany, and Union Bank of Switzerland and Swiss Life, among others, all launched joint ventures in the 1990s. Figure 5-3 illustrates the organizational structure of a bancassurer that has used the joint venture entry vehicle.

Figure 5-3:

Financial Services Integration via Joint Venture Arrangement



Source: Skipper, OECD, 2001

If a prospective bancassurer wanted to minimize the organizational entanglement and upheaval that the combination of two very different types of firms can entail, a third alternative to a merger or acquisition was a simple distribution alliance, which is an agreement between a bank and an insurer that would allow the bank to distribute insurance products to its customers. This entry vehicle has made the most headway in the United States and is the predominant form of bancassurance in America today. Entering into a distribution alliance is simply the alternative with the least hurdles for a bank trying to enter the insurance market; partnering with or even purchasing a local insurance agency is far easier and cheaper than acquiring a national, publicly traded insurer.

The banking industry's preference to enter the insurance industry through the acquisition of insurance agencies instead of insurance companies relates largely to size. Generally speaking, most insurance agencies are independently owned businesses that represent one or more insurers for the purpose of selling coverage to buyers. Agencies act as middle-men and are one of the most important distribution channels for insurers. Because insurance agencies are typically much smaller than the insurers that they represent, they are easier for banks to buy. An insurer, on the other hand, assumes the risk of an insured's loss for a premium, and often relies on increasing its size across states or an entire country as means of achieving increased diversification of risk.

For most of the past 10 years, however, life insurance sales through banks lagged and did not live up to expectations, and, as a result, some banks who had in fact acquired insurers, including Bank of America, Union Bank of California, Capital One, and Webster Bank, divested (Campbell, 2009). Those engaged in distribution alliances, on the other hand, were simply discouraged with life sales that showed "no signs of life" and began to view insurance sales as irrelevant (Ackerman, 2010). According to the Michael White – Prudential Bank Insurance Fee Income Report, however, this perceived irrelevance is directly related to the size of the bank. Table 5-1 shows that larger banks have lower noninterest income concentration (NII), a measure of the percentage of noninterest income derived from insurance brokerage fee income:

Table 5-1:

Community banks are achieving relevance in insurance distribution

	Category	Median assets	Median insurance brokerage fee income[1]	Median NII concentration[2]
Group 1	Top 50 bank holding companies by assets	$62.4B	$9.6M	1.0%
Group 2	Top 50 bank holding companies by NII concentration[2]	$0.9B	$4.1M	36.5%

Note: 1) Excludes income earned from annuity sales and from insurance underwriting.
2) Percent of non-interest income from insurance brokerage fee income.

Source: 2009 Michael White – Prudential Bank Insurance Fee Income Report

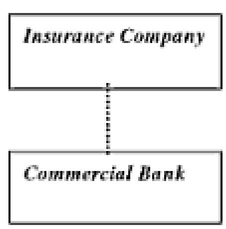
Source: taken from Campbell, 2009

Simply, most large banks viewed insurance sales as ancillary and unimportant because they weren't generating a significant proportion of their noninterest income. More recently, however, there has been a shift. As the stock market improved in 2009, fixed annuities sales decreased and variable-annuity sales increased, as they typically do when the market picks up. However, variable annuities became less attractive as insurers pared down benefits, and, when customers began looking for an alternative product, many chose life insurance (Ackerman, 2010).

Although most large banks have had minimal involvement in developing subsidiaries in the insurance sector, a handful of large banks have recognized the potential for selling insurance to an established customer base. Banks like BB&T, Wells Fargo, First Tennessee, and Citizens Financial Group led the way. United California Bank, among others, forged a distribution alliance with Aon, an insurer, in 2001 to distribute additional insurance products. Figure 5-4 illustrates the organizational structure of a bancassurer who has used the distribution alliance, or marketing arrangement, entry vehicle.

Figure 5-4:

Financial Services Integration via Marketing Arrangement
(Bancassurance)



Source: Skipper, OECD, 2001

Chapter 6

Reasons for Unfulfilled Expectations

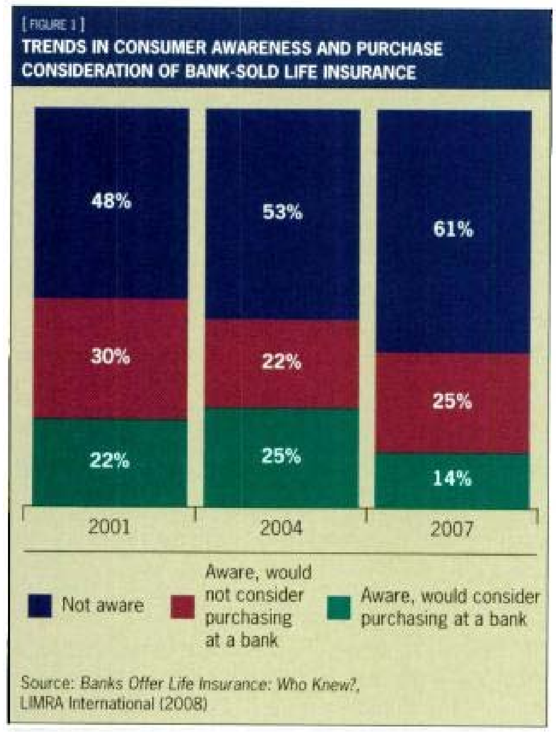
Despite the progress of the bancassurance model since the passage of the Gramm-Leach-Bliley Act by alternative means of entry, the expectations for the bill's impact went largely unfulfilled, for a variety of reasons. Most importantly, perhaps, the idea that banks would immediately begin snatching up insurers was flawed from the outset. Typically, the insurance industry achieves a lower return on equity than the banking sector. Economically, engaging in an acquisition or merger with an insurer was simply notan attractive proposition for banks (Thomas, 2003). According to Robert Stein, former chairman of global financial services at consulting firm Ernst & Young, banks were earning 20% returns on equity in the years following the passage of the Gramm-Leach-Bliley Act, while insurers were floundering at about half that level (Panko, 2005). Ironically, it was banks who had been clamoring for the repeal of the Glass-Steagall Act for years. In hindsight, however, this desire appears to have been nothing more than a case of the banks being lured by the "forbidden fruit," and, once the deals were permitted, they were not as attractive (Panko, 2005).

While disparate returns on equity were a major reason expectations of convergence went unfulfilled,there were others. Huge financial supermarket conglomerates could be inefficient giants, and issues of management and organizational structure often served as barriers to mergers and acquisitions. Citigroup, for example, struggled to impress investors bedazzled by the sheer size and complex management structure of the firm (Reguly, 2009). Not surprisingly, stock price suffered and Citigroup spun off Travelers in 2002. Also, there is an inherent philosophical conflict between banks and insurers. Banks, by nature, are extremely risk-averse, while the insurance industry necessarily includes some volatility and risk. This philosophical dichotomy presents an unattractive option to banks reluctant to assume risk.

Another reason for the lack of convergence among banks and insurers is that the supposed successes of the bancassurance model in Europe were perhaps both overstated and not replicable in the United States. ING of the Netherlands, for example, was the archetypical European bancassurer, using economies of scale and capital efficiencies to become one of the world's leading financial institutions. However, the company's struggles led to a European Union-forced restructuring and a divestiture of its insurance arm. One pitfall that ensnared ING was an accounting loophole called double leveraging, by which the firm could use the same capital against both the banking and insurance arms (Reguly, 2009). This accounting practice, illegal in the United States, permitted bancassurers to go further with less, making them appear artificially strong until poor economic conditions arose. Prospective bancassurers would be unable, and, given the recentfailures of certain European bancassurers, perhaps unwilling to mimic this accounting maneuver in the United States. These failures of bancassurers also demonstrated that one of the most significant supposed benefits of the bancassurance model, safety through diversification, proved inapplicable in times of economic stress (Reguly, 2009).

Another expectation of the post-Gramm-Leach-Bliley Act financial services industry was a boom of insurance sales through banks. Until recently, however, life insurance sales through banks that had entered into the insurance market lagged. However, the more recent surge in life sales through banks, along with the superior profit margins of insurance products versus bank products, indicate that the previous slump in life sales was merely a failure of marketing. Recent evidence suggests that customers were simply unaware that they could purchase insurance products from banks. Figure 6-1 demonstrates the lack of customer awareness about the option to buy life insurance from banks (Painter-Eggers, 2000). It is worth noting that the percentage of consumers who were unaware actually increased through the years, and reached 61% in 2007.

Figure 6-1: Trends in Consumer Awareness and Purchase Consideration of Bank-Sold Life Insurance



Source: Painter-Eggers, 2008

Chapter 7

Conclusion

The Gramm-Leach-Bliley Act removed restrictions between banks and insurance companies that had been there since the Great Depression. Both politicians and experts predicted a substantial flood of mergers and acquisitions. This convergence would lead to the widespread adoption of the bancassurance model, the combination of banking and insurance services that had become so successful in Europe. Finally free from Glass-Steagall restrictions, financial institutions could apply this model and usher in a new era of financial supermarkets, or "one-stop-shops."

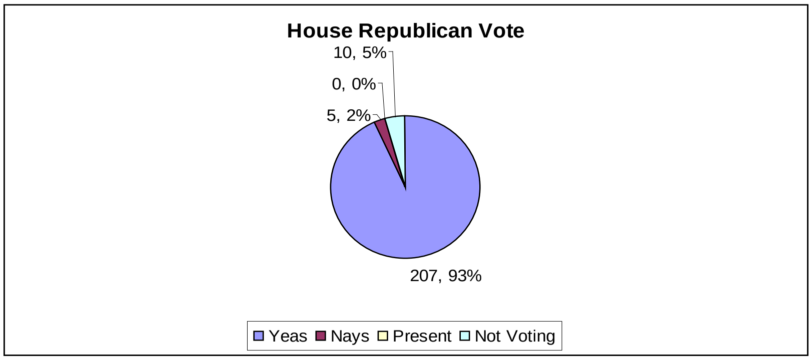
Most of these expectations never came to fruition, as there was little convergence through mergers and acquisitions. The reasons many of the experts' predictions never came true included disparate returns on equity between banks and insurers, inefficiencies of overly complex management structures, inherent philosophical differences between banks and insurers, the overstatement and non-replicability of European bancassurance successes, the pitfall of double leveraging, the myth of safety through diversification in times of stress, and a failure of marketing. While many expected the bancassurance model to take off without Glass-Steagall restrictions holding it back, this confluence of factors prevented such a bancassurance boom.

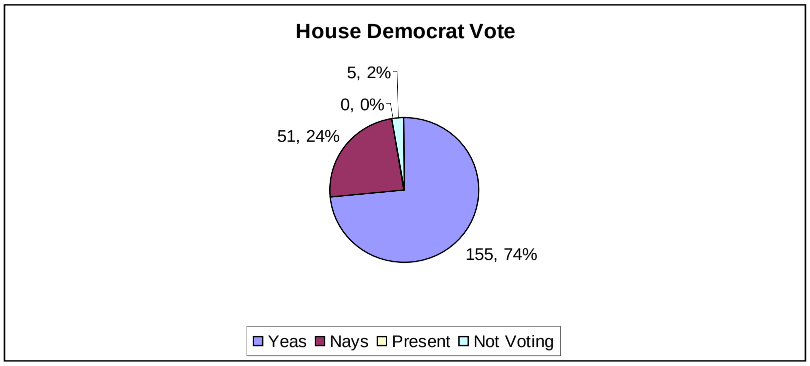
The bancassurance model progressed through other entry vehicles, however, including de novo entry, joint venture, and distribution alliance. De novo entry entails the formation of an entirely new company under a parent company. While US banks have not embraced this entry vehicle, a number of US insurers have used it to enter into the banking sector. In a joint venture, a bank and an insurerset up a jointly owned entity usually offering insurance products to the bank's customers. Although several European banks and insurers have launched joint ventures, this entry vehicle has not been heavily utilized in the United States. Instead, distribution alliances, agreements between a bank and an insurer that would allow the bank to distribute insurance products to its customers, have become the most common form of bancassurance in the United States, and life insurance sales through banks have recently surged.

Appendix

Vote Summaries

Figure A-1: Vote Summary, House of Representatives





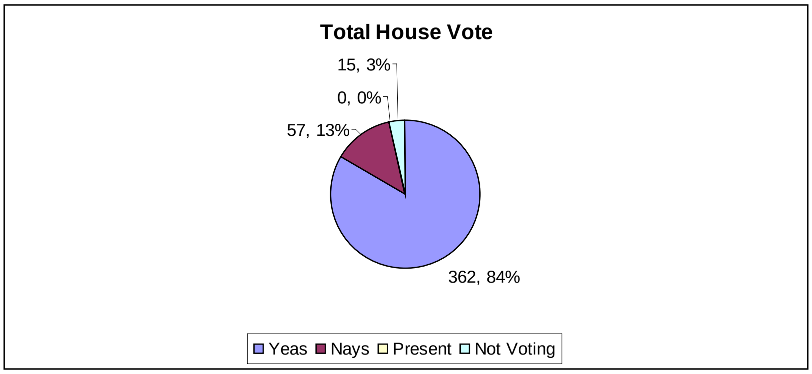
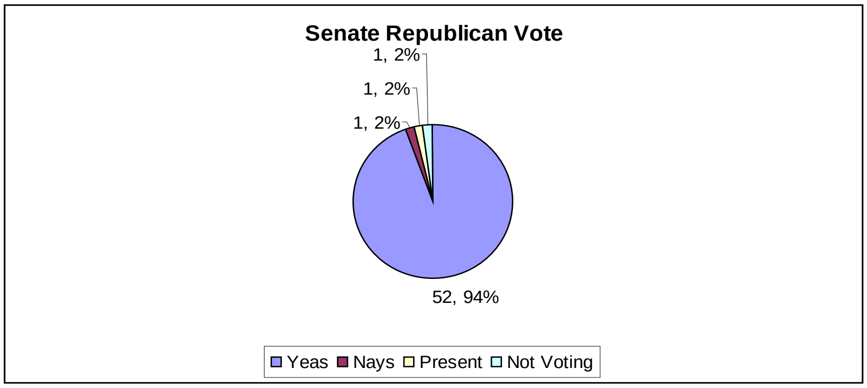
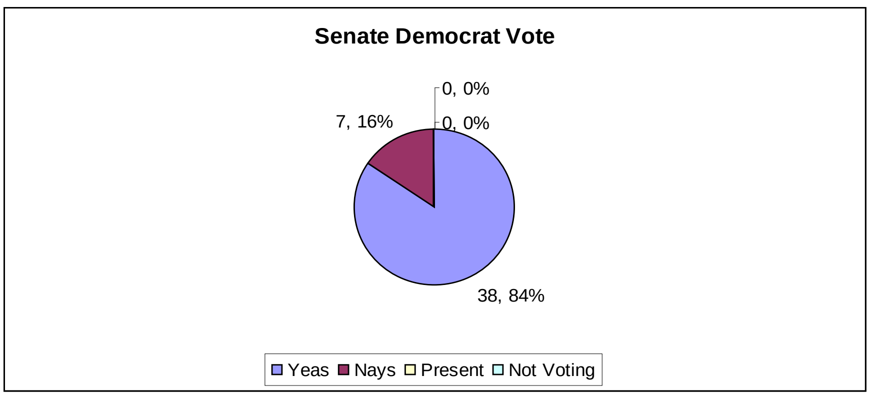
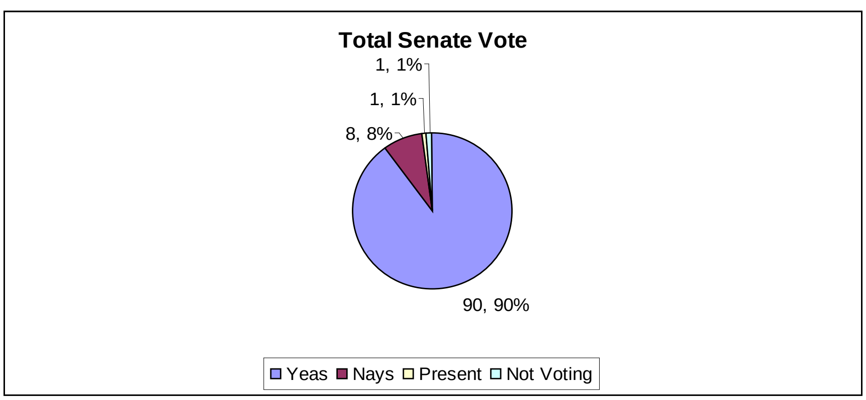


Figure A-2: Vote Summary, Senate







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