Restructuring of the bancassurance sector in Spain

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Financial sector restructuring has had important implications on *bancassurance* in Spain. Consequently, significant reshuffling among the key players, as well as those of the Spanish life insurance sector itself, is expected over the coming year.

The historical connection between banking and life insurance products has boosted the development of the bancassurance *sector in Spain, becoming the main distribution channel for insurance products in this country, above traditional channels, such as agents and insurance brokers. The reduction in the number of deposit institutions through several integration processes, a direct consequence of the present financial crisis, has caused conflicts among the different commercialization agreements established between insurance and credit institutions. Entities involved must solve these conflicts before January 1st 2014, as required by the Bank of Spain.*

Introduction

The historical connection between banking and life insurance products, and the cross-selling between traditional banking products, such as mortgages, risk life insurance and loan amortization insurance, has boosted the development of the *bancassurance* sector in Spain, becoming the main distribution channel for insurance products in this country, above traditional channels, such as agents and insurance brokers.

While life insurance products have shown strong growth within the *bancassurance* channel, the distribution of non-life insurance products through credit institutions' commercial networks is still not significant compared to the level reached in the life insurance business. However, in other insurance areas, it might be considered as the natural distribution channel, for example in the home insurance business.

Without a doubt, the growth of the *bancassurance* business could be explained by a series of incentives that both credit institutions and insurance companies have had in order to promote the commercialization of insurance products through banks, savings banks and credit cooperatives.

Incentives for credit institutions include the following:

- The proceeds received by credit institutions for distributing insurance products, either in the form of commissions or as dividends originated by their own subsidiaries. These proceeds represent a major source of earnings that allow credit institutions to compensate for the reduction in financial

[1] A.F.I. - Analistas Financieros Internacionales, S.A.

margins. In this respect, and in contrast to what happens with other financial products, it is important to point out that in many cases, clients do not assume the commissions that credit institutions charge for the commercialization of their products.

- Cross-selling of insurance products, mainly those linked to asset transactions and fundamentally to mortgages, such as loan amortization life insurance, home insurance, payment protection insurance, etc. This cross-selling technique allows credit institutions to obtain a more profound link with the client.

- A more favourable fiscal treatment for some savings life insurance and especially for pension plans. This represents a competitive advantage when compared to banking products, and has been one of the keys for their growth in Spain.

- Life insurance products do not cannibalize banking products or traditional savings from clients of credit institutions.

Among the incentives for insurance companies, we highlight the following:

- Credit institutions extensive commercial network has allowed insurance companies to gain access swiftly to a nationally established distribution network.

- Insurance products' distribution exclusivity.

- Client base and commercial information exploitation that credit institutions have from clients experience in insurance products commercialization.

- More familiarity in client perception from both banks and savings banks with respect to insurance companies.

- Greater experience in sales and marketing from the banks relative to insurance companies.

Unlike other countries, in the Spanish case, it is important to highlight that when we talk about the *bancassurance* sector, we are not only referring to the distribution of insurance products through credit institutions commercial networks, but it is also very common to include the distribution of pension plans. In fact, the majority of agreements between insurance companies selling life insurance products and credit institutions include the distribution of pension plans.

Distribution of insurance products through banking networks

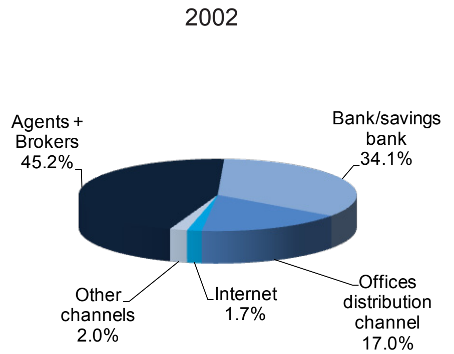
The Spanish *bancassurance* channel has a significant weight within the Spanish insurance sector, specifically regarding life insurance products. In 2011, 71.4% (21.4 billion euros) of life insurance premiums came from credit institutions commercial networks, while the *bancassurance* channel only represented 10.2% (more than 3 billion euros) of the total non-life insurance premiums. Combining life and non-life, the premiums from the *bancassurance* channel were 40.8% of the total in 2011.

This bigger weight of the *bancassurance* channel in the distribution of life insurance products is a common pattern in almost every European national market, except in the United Kingdom and Ireland, where the majority of life insurance products are distributed through brokers. The countries where the *bancassurance* channel has more weight in the life insurance business are Spain, Italy and France.

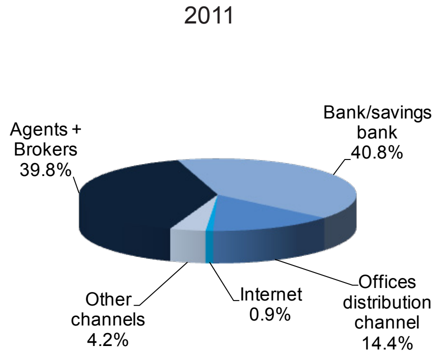
The Spanish bancassurance *channel has a significant weight within the Spanish insurance sector, specifically regarding life insurance products.*

Exhibit 1

Premiums by distribution channel, 2002-2011



Source: Spanish Insurance Supervisor. (Dirección General de Seguros y Fondos de Pensiones), *2002.*



Source: Spanish Insurance Supervisor. (Dirección General de Seguros y Fondos de Pensiones), *2011*

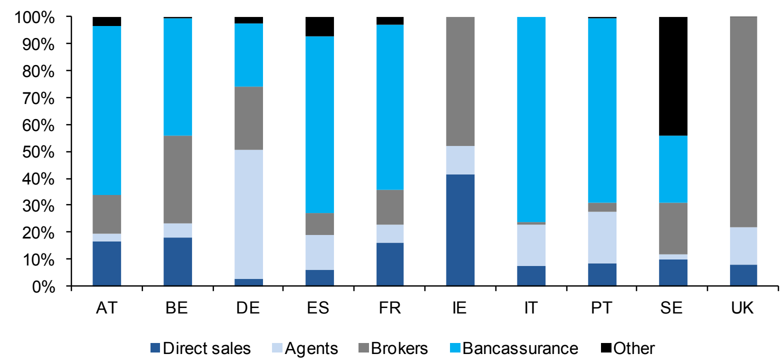
In the rest of the European countries, as it happens in Spain, the commercialization of non-life insurance products represents a small percentage, around 10%, and even non-existent in some cases such as Ireland.

Given the heterogeneity of non-life insurance products, the distribution through financial institutions is quite different among them, but in general, its weak connection with loans of credit institutions accounts for the lacklustre development of its commercialization through credit institutions. However, in the past years, an upward trend can be signalled in the distribution of these products through the commercial networks of credit institutions.

In Spain, the non-life insurance products that register a bigger penetration within the *bancassurance* sector are home insurance (38.1%) and pecuniary

Exhibit 2

Life insurance distribution channels (2010)

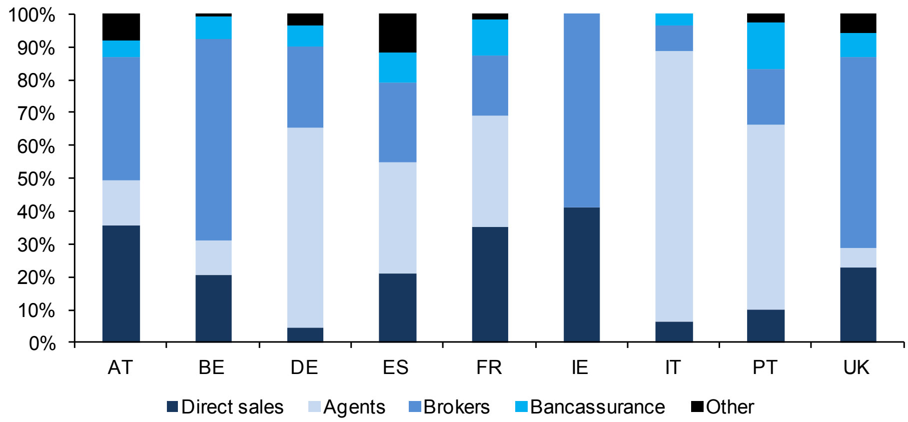


Notes: For UK, bancassurance *is included in all other channels and cannot be separated out. For NL, agents are included in brokers; For DE, SE and UK, figures refer to new business. 2009 data for ES & PL.*

Source: Insurance Europe.

Exhibit 3

Non-life insurance distribution channels (2010)



Note: For NL, agents are included in brokers and bancassurance *is included in "Other".*
Source: Insurance Europe.

losses or payment protection insurance (28.2%), due to their link with the granting of mortgages and personal loans[2].

Bancassurance operator

Before the introduction of Spanish Law 26/2006 of July 17th, regulating insurance mediation and private reinsurance, credit institutions sold insurance products operating as normal insurance agents. After 2006, an important separate role was recognized for these *bancassurance* institutions, thus creating a new form of insurance agent, called the *bancassurance* operator.

Consequently, all credit institutions must have a *bancassurance* operator in order to commercialize insurance products through their banking networks. This role can be played by the credit institutions themselves or by companies controlled or owned by them. This can be made through the execution of an insurance agency contract with one or more insurance companies, and the registration in the administrative record of insurance mediators as an insurance agent using the distribution networks of the credit institutions.

The credit institutions in Spain can make their distribution network available to the bancassurance *operator.*

Like the rest of the insurance agents, *bancassurance* operators can be defined in two ways, depending on their connection with the insurance company:

- Exclusive *bancassurance* operators, are those who sign an insurance agency contract with only one insurance company. The insurance company can authorize the agent to operate with a different insurance company in the insurance areas where the first entity may not operate.

[2] 2011 data. Source: Spanish Insurance Supervisor. (Dirección General de Seguros y Fondos de Pensiones), 2011.

- Non-exclusive *bancassurance* operators, are those who sign an insurance agency contract with several insurance companies. This is the option chosen by most of the entities, from all the 86 *bancassurance* operators, 62 have non-exclusive status, while 24 chose exclusive status. However, many linked operators have exclusivity distribution agreements with insurance companies for specific insurance businesses.

In addition, *bancassurance* operators must be registered in the official registry for insurance mediators, meeting the following requirements:

- *Bancassurance* operators have to be a credit institution or a company controlled or owned by the credit institution. In this case, the connection between both must be regulated by a contract for service provision consisting of the transfer of the credit institution's distribution network to the *bancassurance* operator for insurance mediation.

- The Board of Directors of the institution, responsible for insurance mediation, must meet the required qualifications.

- The institution must have a distribution network personnel training program. Personnel must directly participate in insurance mediation.

- Non-exclusive *bancassurance* operators must indicate in their annual report detail regarding network or networks through which the insurance mediation will be developed.

Business models in *bancassurance*

The distribution of insurance products through credit institutions can be structured into different business models, depending on the interests and objectives both from the insurance company and the credit institution. Despite the fact that these agreements register a lot of special features depending on each case, we can classify them into four broad categories or groups, based on the Spanish experience and on the commercial, organizational and shareholder implications that these agreement have for each institution.

- **General distribution agreements,** in this case, credit institutions commercialize insurance products coming from different

Table 1
Business models in *Bancassurance*

Business model	Description
General distribution agreements	Credit institutions distribute insurance products from one or more insurance companies in exchange for commissions from their commercialization, with no further link between the institutions.
Exclusive distribution agreements	Credit institutions distribute insurance products exclusively from one insurance company without the necessity of creating an insurance company for that same purpose.
Joint ventures	Creation of a new insurance company by the credit institution and the insurance company, owning 50% each. Incorporates exclusivity for the commercialization of insurance products.
Groups of financial services	The insurance company integrates itself 100% in the financial group, meaning the insurance subsidiary is fully owned by the credit institution.

Source: Afi.

insurance companies in exchange for commissions, as any other agent does, but with no shareholder agreement or any strategic link with the insurance company. In this way, both institutions remain independent and their connection is established through a commission contract for the distribution of insurance products.

- **Exclusive distribution agreements,** the credit institution commits to exclusively commercialize the products of the insurance company. This agreement can be applied to every insurance business of the entity, or only to a specific one. It is common practice that the credit institution reaches an agreement with the insurance company for the life insurance business and it reaches another exclusive agreement with a different insurance company for the non-life business.

In Spain, on the one hand, credit institutions' business models for general insurance or non-life insurance products have been skewed towards an open business architecture, by offering their clients products from different insurance companies. On the other hand, with life insurance products, the model has been traditionally based on exclusive agreements with one insurance company. However, in the past years, this model has also been extended to the non-life insurance business.

As is the case with joint ventures, it is very common that when an exclusivity distribution agreement exists, the retribution diagram is based on the initial payment for that exclusivity, and additional payments by the insurance company are made in the medium and longer term, subject to the achievement of certain goals set in the business plan.

- **Joint venture 50/50,** the creation of an insurance company, comprised of the credit institution and the original insurance company at 50% each. This new entity will act as a "factory" for creating insurance products to be distributed through the commercial network of the credit institution. This means one more step in the integration of both insurance and banking businesses.

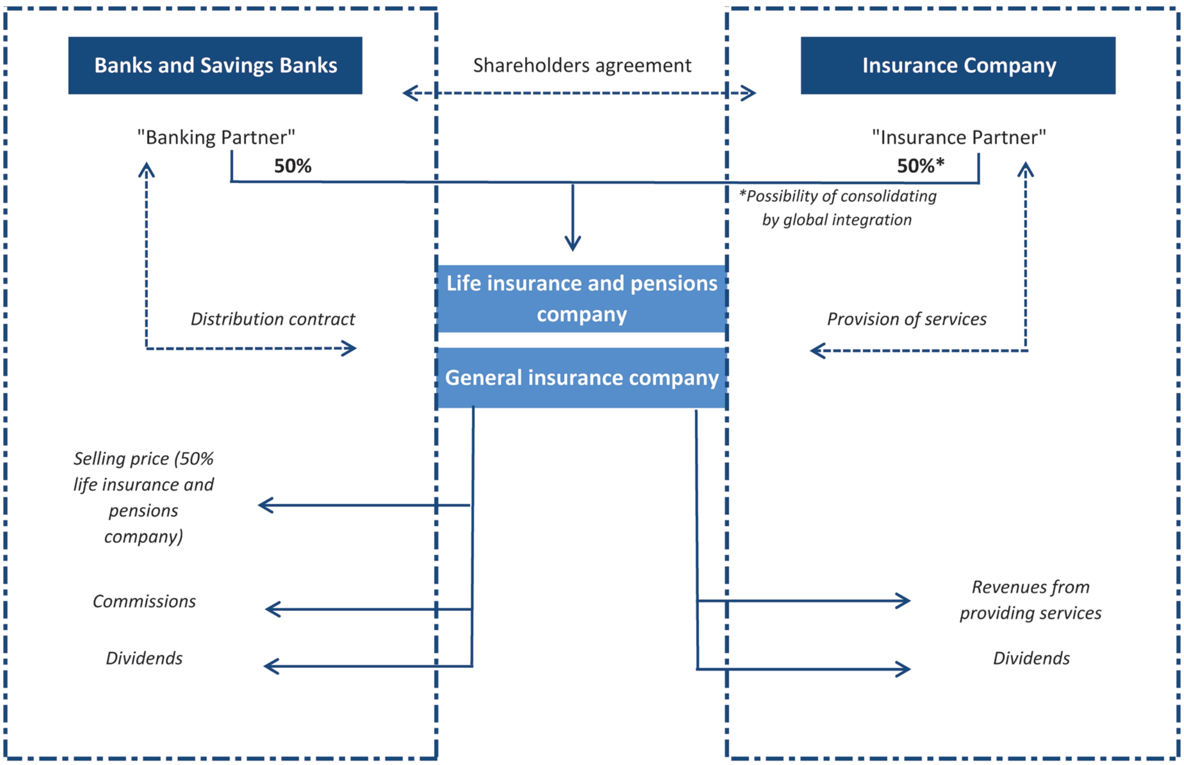
The joint ventures' usual structure is based on the distribution of 50% of the shares for each undertaking, but with the possibility for the insurer to fully consolidate it in its accounts through the payment of a premium by the insurance partner. Through this formula, the exclusivity of commercialization is guaranteed in the medium and longer term (5 to 10 years), with very favourable commissioning conditions for the insurance company.

One of the main factors that has boosted the *bancassurance* business model development through joint ventures and exclusive distribution agreements is that the participation of credit institutions in insurance companies exceeding 10%, is deducted from own funds calculations, when calculating minimum capital requirements[3].

Additionally, through joint ventures, credit institutions have reduced their participation in their insurance subsidiary, and therefore improved their solvency ratios, keeping at the same time certain control over the subsidiary and obtaining a capital gain when that participation is sold. The same conclusion could be reached in the case of exclusive distribution agreements. Credit institutions achieved almost the same

[3] Circular 3/2008, May 22nd, Bank of Spain, to credit institutions, about controlling the minimum funds requirements. Basel III sets this percentage at 10%.

Exhibit 4
Joint ventures structure model



Source: Atlas Capital.

effect but without having to own shares of the insurance company and therefore have their solvency ratios affected.

- **Groups of financial services.** In this case, the insurance subsidiary is completely owned by the credit institution, so there is complete vertical integration in the organizational structure of the credit institution. Nowadays, there are only a few credit institutions that keep using this business model, including BBVA or Kutxabank.

Consolidation of the Spanish financial sector and effects on *bancassurance* agreements

One of the most remarkable transformations that the Spanish banking system has witnessed in the last years, as a consequence of the financial crisis, is the reduction in the number of deposit institutions, especially of savings banks, due to the consolidation processes that have taken place.

As seen in the next exhibit, in December 2009, the census of the Spanish banking system (defined as the set of deposit institutions in the country), rose to 192 institutions: 65 banks, 46 savings banks and 81 credit cooperatives. If we add the 88 foreign businesses, the number of financial institutions increases to 280 entities, without taking into account 70 financial credit establishments (EFC or *Establecimientos Financieros de Crédito*) and the Spanish Official Credit Institution (Instituto de Crédito Oficial - ICO). A census of this magnitude implies a high level of competition between entities, causing, in times of crisis, integrations, searching for synergies and economies of scale, and in the worst-case scenario, nationalizations of the weakest institutions.

The consolidation processes have reduced the number of national deposit institutions to 108 institutions as of February 2013, 44% less than in 2009, which means a decrease of 84 institutions. Of the 108 remaining institutions, 54 are banks, 11 are former savings banks, 2 are savings banks and the 41 remaining are credit cooperatives. Undoubtedly, the major transformation has taken place in the area of the savings banks, because from the original 46 institutions, only 2 remain with their original legal nature (institutions of private law with a non-profit nature), including the confederation of savings banks CECA. The subsystem of credit cooperatives has also decreased considerably since 2009 (49%), but has kept its legal configuration.

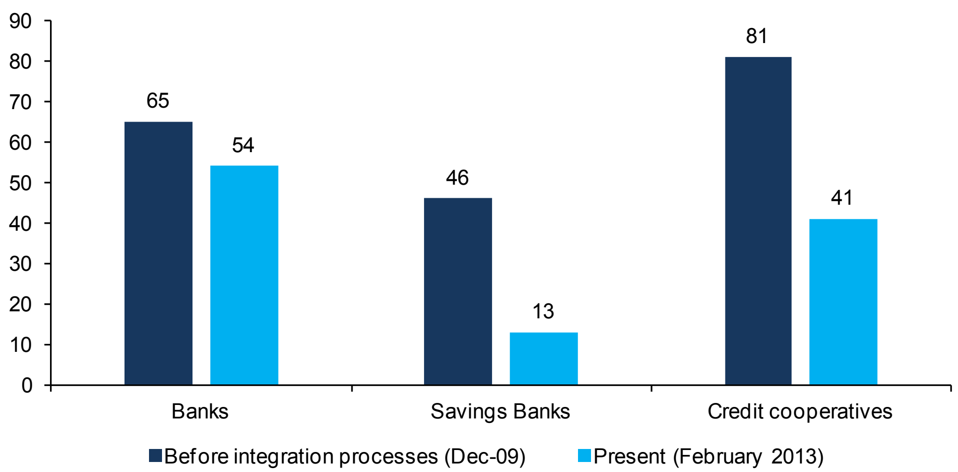
The previously mentioned consolidation processes carried out among the Spanish credit institutions have caused conflicts among the different commercialization agreements established between insurance and credit institutions, because in many cases the insurance partners of the merged credit institutions were different.

Therefore, a credit institution may have found itself with two or more different insurance partners, and in most cases, the distribution agreements, as we mentioned before, include clauses with commercialization exclusivity for insurance products, whether they are life products or non-life products.

Even though the resolution of these agreements is very hard and complex, that situation cannot be extended indefinitely, so the Bank of Spain has given the credit institutions that were involved in

Exhibit 5

Deposit institutions census Dec 09 compared to Feb13



Sources: Bank of Spain Statistical Bulletin, AEB, CECA, UNACC and Afi.

consolidation processes until January 1st, 2014, to resolve these situations[4].

The Bank of Spain has given the credit institutions that were involved in consolidation processes until January 1st, 2014, to resolve conflicts with their previous bancassurance operators.

In this context we can examine some of the latest transactions that have taken place in the *bancassurance* sector. (Exhibit 6 provides a clear picture of the current situation):

- Purchase by BBVA, once UNNIM BANC was integrated, of the shares that the insurance partners from UNNIM held in various insurance subsidiaries, specifically:
  - Reale - 50% of the general insurance subsidiary, for 68 million euros.
  - AEGON - 50% of the life insurance and pensions subsidiary, for 352.5 million euros.
- Purchase by Bankia of 50% of the life insurance and pensions business of ASEVAL, subsidiary of the former Bancaja, from AVIVA, for 608 million euros.
- Purchase by Caixabank from AEGON of 50% of the joint venture the latter had with Banca Cívica Vida y Pensiones, Caja Burgos Vida and Can Seguros de Salud with Banca Cívica for a total amount of 190 million euros, plus the purchase of 50% of the two joint-ventures that CASER had with CajaSol, one for the life and pensions business, and the other one for general insurance. Finally, the purchase of 50% of the joint venture that CASER had with Caja Canarias for the general insurance business, for a total amount of 215 million euros.

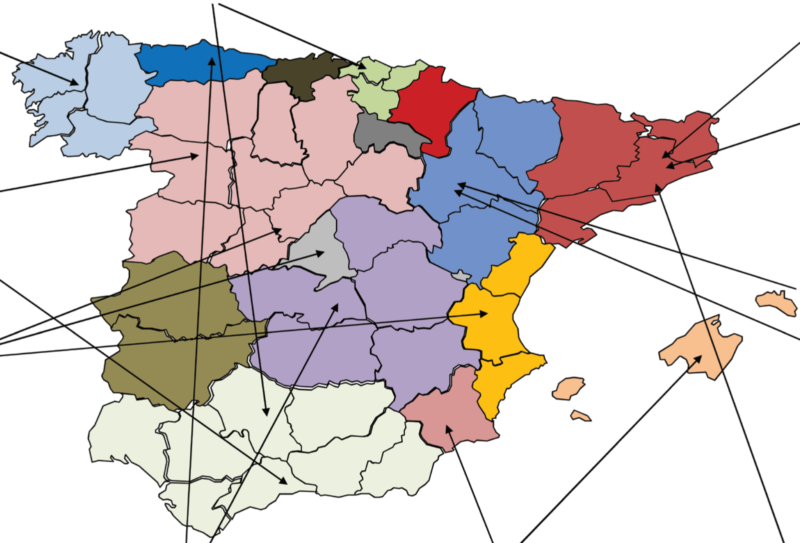
Despite the aforementioned transactions, there are still credit institutions with remaining exclusive commercialization agreements with different insurance companies, such as BMN, Novagalicia Banco, Bankia, etc. Therefore, in the upcoming months, transactions like those previously mentioned will take place, orientated at rationalizing insurance agreements.

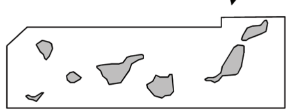
The resolution of these agreements is not only relevant to the *bancassurance* subsector. Given its strong weight in the life insurance business, the consequences of the restructuring of the financial system can cause movements in the insurance sector, due to the fact that some insurance companies ended up out of the sector and might need to rethink their business strategy through other distribution channels, or because new agents might appear in the insurance market, as has been the case following the purchase of 50% of the business of Segurcaixa Adeslas by Mutua Madrileña in 2011.

[4] Through the Royal Decree 2/2012, from February 3rd, for reorganization of the financial system.

Exhibit 6

Bancassurance agreements in Spain (as of February 2013)





NCG BANCO	Life	Non-Life
Caixa Galicia	Aviva	-
Caixanova	Caser	Caser

BANCO SANTANDER	Life	Non-Life
Banco Santander	AEGON	AEGON
Banesto	AEGON	AEGON
Banif	AEGON	AEGON
Openbank	AEGON	AEGON

BANCO CEISS	Life	Non-Life
Caja España	Aviva	-
Caja Duero	Mapfre	-

UNICAJA BANCO	Life	Non-Life
Unicaja	Aviva	-

BANKIA	Life	Non-Life
Caja Madrid	Mapfre	Mapfre
Bancaja	-	Groupama
C.A. Insular	Caser	Caser
CA Avila	Caser	Caser
C.A. Segovia	Caser	Caser
C.A. Rioja	Caser	Caser
C.A. Laietana	-	-

BBK	Life	Non-Life
BBK	Biharko	Biharko
Cajasur*	Biharko	Biharko

LIBERBANK	Life	Non-Life
Cajastur	AEGON	-
CCM	Mapfre	-
Caja Cantabria	AEGON	Caser
C.A. Extremadura	AEGON	-

BMN	Life	Non-Life
C.A. Murcia	Aviva	Caser
C.A. Granada	Aviva	Caser
C.A. Penedés	Caser	-
Sa Nostra	Caser	Caser

CAIXABANK	Life	Non-Life
La Caixa	Vidacaixa	Mutua Madrileña
CajaSol	Vidacaixa	-
C.A. Canarias	Vidacaixa	-
C.A. Navarra	Vidacaixa	Zurich
C.A. Burgos	Vidacaixa	-

CATALUNYA BANC	Life	Non-Life
Caixa Catalunya	Mapfre	Mapfre
Caixa Tarragona	Mapfre	Mapfre
Caixa Manresa	Mapfre	Mapfre

BBVA	Life	Non-Life
BBVA	-	-
UNNIM	-	-

IBERCAJA+CAJA 3	Life	Non-Life
Ibercaja	-	-
CAI	-	Reale
C.A. Badajoz	AEGON	-
C.A. Círculo	Caser	

BANCO POPULAR	Life	Non-Life
Banco Popular	Allianz	Allianz
Banco Pastor	Axa	Tranquilidade

BANC SABADELL	Life	Non-Life
SABADELL	Zurich	Zurich
CAM	AEGON	-

Source: Afi.