ADVANTAGES AND DISADVANTAGES OF COOPERATION BETWEEN BANKS AND INSURANCE COMPANIES

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Abstract: *Financial derivatives are financial instruments that cause major changes in financial markets. They appeared in order to protect the transistors' from a certain form of market risk, but also with the intention of making profit.*
The paper analyze a topic related to the forms of cooperation between the financial market entities, especially the cooperation between banks and insurance companies in the sphere of sale of insurance policies, to be more precise - bank insurance.
Banking and insurance are complementary parts of the financial system. Bank insurance is relationship between a bank and an insurance company, whereby the insurance company uses the bank sales channels in order to sell insurance products, an agreement in which a bank and insurance company agree in a way that the insurance company can sell its products to customers of the bank.
Insurance companies sell their insurance products through their direct sales network or through distribution channels, of which the most important are insurance brokers and agents. With the involvement of banks in the sale of insurance products in the 1980s, the development of bank insurance began in Europe and since then it has become increasingly widespread throughout the world. In the narrowest sense, bank insurance implies the sale of insurance products through a bank, while in a broader sense it is defined as a joint venture between banks and insurance companies in order to enable insurance products to reach customers of banking services.
Banking is a winning combination for both institutional partners in a business relationship. The Bank enriches the offer of financial services for its customers by selling or integrating insurance products, while at the same time it receives a new source of income, while the insurance company uses the bank's marketing and increased sales through access to a significantly larger potential customer base. The focus of the bank are the consumers, and the success of this business cooperation depends on the synergy of the three most important elements, namely marketing strategy, organizational culture and market conditions.
The banks and insurance companies have certain problems in its functioning, which can arise as a result of several reasons. The problem with the functioning of the bank insurance is in the various sales philosophies of banks and insurance companies. Banks have a passive sales philosophy, conditioned by traditional demand, while insurance companies have an aggressive sales philosophy.

Keywords: *Financial derivatives, financial market, bank insurance, banks, insurance companies*

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1. INTRODUCTION

Starting from the 1990s, the classic work of banks and insurance companies on the financial market has changed as a result of the new and different needs of the clients, strengthening and developing the competition, reducing the costs in terms of gaining competitive advantage, superiority and increasing of profits.

The method of delivery of insurance products with the development of technology changes in accordance with the needs and wishes of the clients, which implies the sale of insurance with complete financial service. This implies innovations of the distribution network for the sale of insurance products in the direction of various forms of cooperation of the insurance companies with the financial institutions - banks.

The cooperation of the banks with the insurance companies, as a method is quite widespread in the US and Europe, and recently it is more often implemented in Republic of Macedonia.

The insurance is slowly, but surely becoming one of the most attractive options for expanding the banking business. The term "bank insurance" originally appeared in France, which has been operating as a model in Europe since 1980 and indicates a simple distribution of insurance products by bank branches, in that way the bank fully using its customer base as potential users of some type of insurance. [1]

When it comes to the interest of the involved parties in such transactions, both sides are benefiting. Banks find their benefits in the additional and stable source of income, while reducing their dependence on the interest margin, offering integrated financial services to an extended customer base, reducing the required capital at risk for the same level of income, an increased source of funds investable and various tax benefits. On the other hand, the insurance companies direct their field of interest towards reducing the dependence on traditional agents and using the distribution channels set by the banks, developing new products in cooperation with the correspondent bank, using a multiple client base, managing with greater available capital, through which they increase their solvency and the possibilities for expansion of the business.

2. COOPERATION BETWEEN BANKS AND INSURANCE COMPANIES – BANCASSURANCE

Bancassurance is a new concept in financial services sector means using bank’s distribution channels to sell insurance products. The meaning of Bancassurance is to combine the manufacturing capabilities and selling products of insurance companies with the distribution network and large receptive clients base of banks. It is a situation wherein insurance products are offered through the distribution channels of the banking services along with a complete range of banking and investment products and services. Bancassurance tries to exploit synergies between both the insurance companies and banks.

Banks and insurance companies are an integral part of one country's financial system. Cooperation between banks and insurance companies can be accomplished through several forms given the fact that the products they offer are complementary.

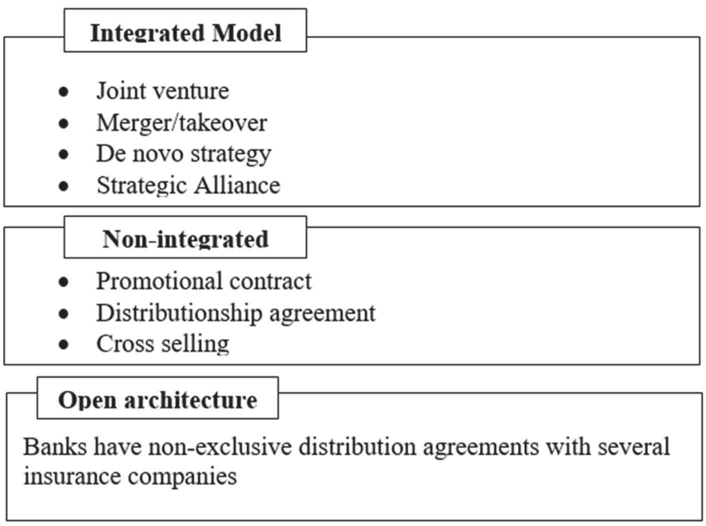
The growing financial market, development of new technologies, universalization of banking industry and the expansion of non-banking activities, has brought rapid development of new channels of distribution on insurance products through banks, leading to a new concept called Bank insurance. This has given rise to a new form of business and has integrated all their strength and efforts to generate new products for potential customers. The growth of bank insurance depends on how well banks and insurance companies are able to conquer the operational challenges that are exposed.

Bancassurance simply means selling of insurance products by banks. Bancassurance is used to describe the partnership or relationship between a bank and an insurance company whereby the insurance company uses the bank sales channel in order to sell insurance products. [6]

In this arrangement, insurance companies and banks undergo a tie-up, thereby allowing banks to sell the insurance products to its customers. By selling insurance policies bank earns a revenue stream apart from interest. It is called a fee-based income. This income is purely risk-free for the bank since the bank simply plays the role of an intermediary for sourcing business to the insurance company. Insurers see it as a tool to increase penetration and market share and bankers use it to augment their fee income and to smoothen the volatility of interest income. Bancassurance is a package of banking and insurance services under one roof.
There are different models of bankassurance in different countries and some of the models are the following: [2]

1. Distribution agreements – in simplest form called “tied agent”, the banks personnel sell the products on one insurer exclusively, either in stand-alone basis or bundled with bank products.
2. Strategic alliances – it is a higher degree of intervention in product development, service provision and channel management by the way of bank investing sizably in insurance business without any contingent liability.
3. Joint venture – it’s about large bank with a well developed customer database partners with a large insurer and a strong product and channel experience, to develop a powerful new distribution model. Alternatively, a bank and insurance company may agree to have cross holdings between them to share the profits.
4. Financial service group – Under further integration between a bank and insurer, an insurance company may build or buy a bank or a bank may build or buy an insurance company.

Figure 1. Bancassurance- Approaches/Models



In this way banks could associate themselves with insurance companies by becoming a distributor or by being a strategic investor or developing a joint venture, or by becoming a promoter. Most of the bancassurance operations fall in the first model. Each of the identified organizational forms of banking and insurance cooperation results in different consequences in terms of specific risks that may occur in the implementation phases of distribution, or the use of bancassurance products.

3. ADVANTAGES AND DISADVANTAGES OF BANCASSURANCE

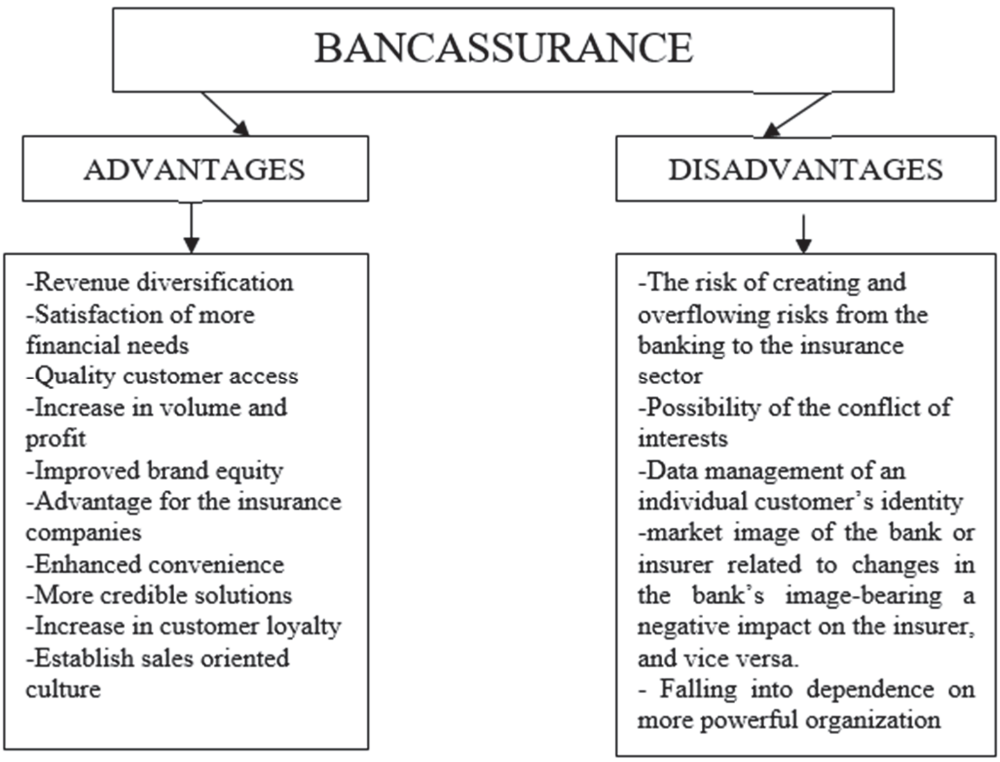
Cooperation relations between insurance companies and banks, including bank insurance, have several advantages and disadvantages for developing both insurance and banking. As the most important positive aspect appears synergistic effect, and negative aspect is the dominant position of the corporation and the problem of calculating the solvency of the insurance company. However, apart from the banks, insurance companies and clients themselves gain significant benefits from bancassurance, as well. The benefits reflect in the following: [3]

- Diversifying their offers - banks have the opportunity to substantially increase the profitability of their network of branches and subsidiaries by means of increased productivity of regularly employed staff, thus providing additional and stable source of income in the form of increased compensations and commissions. This way, the reliance on interest margins (the difference between debit and credit interest rates) as the main source of operating income of banks, is reduced.
- Bancassurance allows insurance companies to sell through banking channels the services that are not suitable for traditional distribution channels of insurance companies. Through this sales channel, insurance companies have access to a new client base - the bank's clients, who represent a completely different segment of the population (according to their buying habits) in relation to potential clients with whom the insurer had dealt earlier. Bancassurance allows the presence of insurance companies in the territories where they have not yet been represented, but where the bank already has its branch offices. In this way, the insurance company does not have to build its own network of insurance agents that requires a lot of time and money.
- The benefits that bancassurance provides to clients are reflected in a complete supply of financial products and services (banking and insurance) in one place. Thus clients can save time and get lower premiums, since insurance companies transfer a part of the reduction of distribution costs to policyholders through reduced premiums.
- Expanding the range of services, leading to additional income, effectiveness of the agent network, reduction of sales channels, competitiveness, receiving detailed information about clients,
- Attraction and prevention from the outflow of capital from the cooperating companies by association of capital non-insurance companies (banks, finance-investment, leasing, consulting, legal, trading companies) with funds of insurance companies,
- Marketing effectiveness of two financial institutions increases thanks to the ability to reach a larger segment of the market (the insurance company’s clients automatically become clients of the bank) and thanks to geographical diversification.

These relationships also have disadvantages. Considering the processes of bancassurance from the financial, functional and marketing angle some attention should be paid to aspects of risk associated with cooperation. Some of the disadvantages are: [4]

- Falling into dependence on more powerful organization, conflict of interest between the partners, emergence of new risks, rise in price and doubling of new financial services,
- Problems of calculating the solvency of insurance companies, the increased volume of work will lead to overwork of the agents, a lack of control by government surveillance,
- There is a possibility of the conflict of interest between the other products of bank and insurance policies. This could confuse the customers regarding where they have to invest,
- Carrying out activities targeted at developing offers, conducting sales and organizing operational areas of cooperation within the bancassurance require special precautions to avoid a situation in which the operational problems of one of the entities involved in the bancassurance will be transferred to the level of customer service of the other of the cooperating partners,
- It is also important to address the implications of taking action to achieve synergy in marketing field. A special area that should be subject to intensive monitoring is the impact of bancassurance cooperation on the brand name of each of the cooperating entities, in particular the problems that may occur in the market image of the bank or insurer related to changes in the bank's image - bearing in mind a negative impact on the insurer, and vice versa,
- The risk of creating and overflowing risks from the banking to the insurance sector due to the deposits of the insurance companies in the banking institutions.

Figure 2. Advantages and disadvantages of bancassurance



Increased competition between banks and insurance companies and the risk of outflow of deposits is due to increased mobility of clients imposed on banks to realize their cooperation with the insurance companies by "binding" the clients, by creating diverse financial services in one place.

4. CONCLUSION

Collaboration and cooperation of financial intermediaries in providing financial services becomes one of the main characteristics of modern economic space. Bancassurance is an up-and-coming business model that enables insurance companies to sell their products through banks distribution channels. Banks benefit by enriching the customer's portfolio, and insurers have access to customer databases, profiles and customers, thus have an opportunity to purchase a broader range of products and services to meet their demanding needs.

Distribution channels for financial products and services, capturing related sectors of the financial market, are expanding, which in return helps to diversify risks, reduce operating costs, expand customer base.[1] Such cooperation is gaining increasingly larger scales. It becomes a common phenomenon and provides new prospects for the development of the financial system and its separate subsystems. Bankassurance has also negative impact of insurers' and banks' joint activities:

One should take into consideration that both financial institutions have to reach agreement on certain organizational, financial, and management issues for conducting joint activities.

On Macedonian market the bankassurance is in initially progress. The banks prevailing attitude is that the insurance is low-profit business, and therefore not interested in developing on this channel sales. [5] Also, end users still do not show much interest in various types of insurance products offered in the market. Insurance companies are still oriented towards development of its own sales channels and an additional problem for the development of bankassurance represents software solutions to implementation of the bankassurance.

Managements of most banks and insurance companies operating in Macedonia are aware of the benefits that bancassurance brings, so they work intensively on the development of this distribution channel. This activity is particularly important in the conditions of global economic crisis, since it will facilitate higher growth of those insurers and banks that are bound by capital and contract in the period after the crisis.

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