A MODEL FRAMEWORK FOR BANCASSURANCE REGULATION IN ZAMBIA.

by

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A dissertation submitted in partial fulfilment of the requirements for the degree of Master of Laws (LLM) (Taught)

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DECLARATION

I, **Augustine Hamwela**, **Computer Number 531001653,** hereby declare that this dissertation represents my original work; and that I have not previously submitted it for a degree, diploma, or other qualification at this or any other University.

I further declare that I have endeavoured to acknowledge work done by others. Finally, I take full responsibility for the contents and any errors, defects or omissions.

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CERTIFICATE OF APPROVAL

This dissertation authored by **Augustine Hamwela** (computer number 531001653) and entitled *A Model Framework for Bancassurance Regulation in Zambia* has been approved as the partial fulfilment of the requirements for the award of the Master of Laws (Taught) by the University of Zambia.

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ABSTRACT

The dictates of modern commerce require that clear regulations govern its key aspects. Insurance plays a vital role in the life of an economy's commerce. The modern trend globally is for insurers to distribute insurance products through a growing variety of intermediaries. The role that banks play as intermediaries in the distribution of insurance products to consumers through their vast networks generates massive business revenues globally. In Zambia, banks and insurance companies have partnered to offer insurance products to consumers in spite of the want of regulations governing these partnerships. This problem is compounded by the fact that these partnerships between banks and insurance companies are proscribed by express provision of law. There lies the problem which this paper seeks to explore and resolve. The paper recommends regulation of *bancassurance* and proposes a framework which such regulation should take. The principal technique adopted in this paper is the social-legal research approach.

To my family and in particular Chilaba and Chileleko

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GLOSSARY OF ABBREVIATIONS AND ACCRONYMS

BFSA – Banking and Financial Services Act

BoZ – Bank of Zambia

CCP – Competition and Consumer Protection

CCPC - Competition and Consumer Protection Commission

IRDA – Insurance Regulatory and Development Authority

FSDP – Financial Sector Development Plan

KYC - Know Your Customer

PIA - Pensions and Insurance Authority

RBI – Reserve Bank of India

SLA – Service Level Agreement

CHAPTER ONE - PRELIMINARY ISSUES

1.1 INTRODUCTION

The golden years of unquestioned reverence towards banks are long over. Numerous scandals have rocked many banks in recent times, from the global economic crisis of 2008/2009 which most analysts attribute to subprime lending (imprudent lending on insufficient collateral) by banks in Europe and the Americas, to the LIBOR setting debacle involving Barclays and other English banks, mis-selling by HSBC and allegations of sanctions-busting by Standard Chartered Bank in New York. It is a matter too plain to contest, that banks have lost their erstwhile high ground and are now viewed with a degree of suspicion by consumers. Regulators have not been far behind in ensuring that banks conduct their business in a manner which accords with the highest standards of probity and the primacy of consumer interest.

The consumer oriented focus of bank regulation necessarily entails that the banking sector the world over has become highly regulated. In this dissertation, the Author shall focus on a specific area of bank regulation in Zambia, namely that relating to *bancassurance*, the practice whereby banks and insurance companies partner to offer insurance products to bank customers[1]. The Author will assert that, in stark contrast to the regulatory trends described above, this area of commerce has not been specifically addressed by legislation/regulations

[1] M Chevalier, C Launey and B Mainguy, "*Bancassurance: Analysis of Bancassurance and its status around the world*," Focus Scor Vie (2005): 6

in Zambia. This research paper is, therefore, ultimately intended to provide a model framework for *bancassurance* regulation in Zambia based on a review of comparable jurisdictions around the world, particularly in Europe and Asia, where the concept of *bancassurance* has been applied and successfully regulated.

In the following sections of this Chapter, the Author broadly discusses *bancassurance* and its attributes, defines the scope of the paper and the issues it is meant to address, highlights the significance of the research paper, and finally discusses the methodology for the study.

1.2 BANCASSURANCE EXPLAINED

Simply put, the concept of *bancassurance* refers to collaboration between banks and insurance companies whereby banks may manufacture, distribute or market insurance products offered by partner insurance companies in one form of construct or other, which ranges in complexity on a continuum depending on the degree of collaboration between the bank and its partner insurance provider[2].

The World Bank[3] in its Policy Research Paper on *bancassurance* defines *bancassurance* as "the process of using a bank's branches, sales network, and customer relationships to develop sales of insurance products". The World Bank asserts that bancassurance is not simply a sales technique. More than that, it is a development channel.

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[2] Munich Re Group, "*Bancassurance in Practice*," Münchener Rückversicherungs-Gesellschaft Munchen (2001): 2

[3] S O Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*." The World Bank, Financial and Private Sector Development, Non-Bank Financial Institutions; Policy Research Working Paper 6196 (September 2012); 8

Violaris[4] provides a concise analysis of what is envisaged by *bancassurance.* A number of models are discussed, from the least integrated to the most cohesive.

The first of these models is the referral model**.** In this arrangement, the bank generates "warm leads" from its normal business operations and refers these to the insurance company, usually for a commission from the insurance company on each lead closed by the insurer.

The second and more structured arrangement is the distribution agreement model. In this model, the insurance partner designs and produces insurance products which the bank partner distributes through its distribution channels. The arrangement may be non exclusive, or exclusive where the bank is precluded from distributing the products of other insurance companies in consideration for an upfront exclusivity fee.

The third model, less frequently encountered than the prior two, is the cross shareholding model, where the bank and the insurance company hold equity in a joint venture company intended to provide the relevant insurance products. Other models include the partial or complete acquisition of the insurance partner by the bank model, the establishment of an insurance company by the bank model and the acquisition or establishment of a bank by the insurance company model.

Essentially, *bancassurance* bridges the product offerings of insurance companies and banks. Both, in their individual roles, play a cardinal part in promoting economic growth both at a micro and macro-economic level. Banks provide,

[4] Y Violaris, *'Bancassurance in Practice',* Munich Re Report, EuroLife, Nicosia (Cyprus) http://www.marclife.com/research/pdf/banc.pdf p. 4

inter alia, capital for commerce in the economy. Insurers provide a risk transfer mechanism and ensure that as businesses and individuals take up more risk, their capital is protected through appropriate insurance cover. Benefits from a synergistic collaboration between banks and insurers are immense. Consumers of both players benefit from the higher capital and less risk mix, while the economy burgeons from the resultant increase in enterprise. [5]

Typical examples of *bancassurance* offerings are finance and repayment insurance products or simply products tied to the provision of credit. The bank availing credit in these arrangements insists that the customer take out insurance to cover the death, partial or permanent disability of the borrower so that in the event that the customer dies, for instance, the customer's family does not have to repay the loan and the bank looks to the insurer for the balance of the loan. The repayment obligation is suspended during the partial disability of the borrower and permanently if the incapacity persists for life[6]. The spectrum of products offered through *bancassurance* can range from life to non life (general) insurance products. Health/medical insurance, education insurance, motor vehicle insurance, other forms of property insurance, professional indemnity insurance, etcetera, can all be sold through this model[7].

The benefit of *bancassurance* generally is that the bank provides a ready market for the insurance company and the volumes allow the insurer to offer cheap cover

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[5] Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*.", **7**

[6] Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*.",13

[7] Ibid 13-16

to the bank's customers. Both the insurer and the bank make colossal profits from *bancassurance* in premiums for the insurer and fees and commissions for the bank. The bank, particular to finance and repayment products, benefits from the avoidance of losses occasioning default on the loan in the case of death or disability of the borrower and by avoiding the negative publicity which comes with pursuing the family of a deceased customer. The customer and his/her family rest assured in the knowledge that should death or disability occur, they shall be absolved from any further repayment obligations and, in the event of a mortgage, their property shall not be repossessed[8]

The World Bank[9] posits that:-

> It is therefore a core issue for the best path forward of many developing countries that the correct emphasis should be placed upon insurance. In particular, it is essential that the best environment - regulatory, legal, social, and political - should be created to foster the effective growth of good insurance products.... As a consequence of these issues, it is important that every country, developing or otherwise, gives careful consideration to the great value of Bancassurance as a means to grow the presence and use of insurance within a community.

The World Bank[10] further notes that though *bancassurance* has really only been in existence for about 30 years (since it was introduced in France), it is emerging

[8] Ibid
[9] Ibid, 5
[10] Ibid

as a natural pathway for the effective development of insurance globally. Plainly, banks around the world can make millions from *bancassurance*. The corollary is that insurance consumption in the economy grows due to bank's distribution networks[11]

1.3 STATEMENT OF THE PROBLEM

This paper posits two principal issues. Firstly, that *bancassurance* arrangements generally fall outside of the current relevant legislative framework in Zambia and are illegal; and secondly that *bancassurance* is not covered in specific legislation in Zambia. The first of these assumptions, as shall be evident in Chapter two, is the subject of a prior academic research paper[12] and the regulatory landscape has not changed since that paper was authored in 2011. It is, therefore, the Author's intention not to belabour that point here.

Regarding the second assumption, it is worthy of note that the word *bancassurance* appears nowhere in legislation in Zambia. The activities and structures envisaged by it are also not evident in statute. It is argued, and the research undertaken in Chapter three shall demonstrate, that it is highly imprudent not to have specific and clear legislation/regulations dealing with *bancassurance* and that the lack of such regulation is certainly a *lacuna* in Zambian law. It is on this second assumption that this paper shall focus.

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[11] G Benoist, "*Bancassurance: The New Challenges*", The Geneva Papers on Risk and Insurance, Vol. 27 Iss: 3 (July 2007) pp. 295-303

[12] **N**dalameta, "*Bancassurance: a Legislatively Premature Entry into Zambia?" (*LLB Diss., University of Zambia, 2011) *38*

In its policy research on *bancassurance* undertaken globally, the World Bank[13] determined that *bancassurance* has had important success in some economies and markedly limited success in others. The principal factor identified to have made the difference in the economies where *bancassurance* has excelled is the regulatory situation, in particular the presence of legislation governing *bancassurance*. In the United States for instance, it is only in 1999 that the Gramm-Leach-Bliley Act removed obstacles to banks selling insurance, which had been in place since the 1933 Glass-Steagall Act. Even then, *bancassurance*, because it entered too late and found well established incumbent distribution models, has not been very successful. The exact same point is made by Benoist[14].

There is clearly a need for legislative intervention in a meaningful sense. The Author suggests that a regulatory framework which accords with the dictates of a modern financial services sector is a necessity. The Author also suggests that there is a danger in continuing to write insurance contracts through the *bancassurance* model, which, it is posited, may be illegal on their face.

Even if *bancassurance* is legal in Zambia, there must be clear regulation of *bancassurance*. The responsibilities of the bank and insurance partner must be defined and delineated so that the consumer is protected; the nature of the possible products clearly defined; and the premium payment and claims processes outlined. As noted above, *bancassurance* is central to the consumer,

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[13] Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*.", **22**

[14] G Benoist, "*Bancassurance: The New Challenges*", The Geneva Papers on Risk and Insurance, Vol. 27 Iss: 3 (July 2007) pp. 295-303

banks, insurers and the general economy. Clear and specific legislation would enhance these partnerships and maximise their potential benefits.

1.4 PURPOSE/OBJECTIVES OF THE STUDY

The paper is meant to answer the question; 'how can insurance and banking regulation and law engender insurance in Zambia?' It will primarily focus on the *bancassurance* model.

The paper shall proceed on the basis of the hypothesis that; '*Bancassurance* although essential for the promotion of insurance is both illegal and not covered by specific legislation in Zambia.'

To test this hypothesis, the research paper shall address the following specific questions:

(a) Do *bancassurance* arrangements engender insurance?

(b) Is *bancassurance* legal/illegal in Zambia?

(c) Is *bancassurance* sufficiently regulated in Zambia?

(d) Is there a clear and present need for an overhaul of the regulatory framework pertaining to *bancassurance* in Zambia?

On the back of the four questions above, the objective of the study is to propose a framework for the regulation of *bancassurance* in Zambia based on international best practice in more mature financial markets than Zambia.

1.5 SIGNIFICANCE OF THE STUDY – THEORY AND PRACTICE

The study adds to the literature on the subject of *bancassurance* in Zambia. A previous work on this subject by Ndalameta, referred to above and discussed in more detail in Chapter two of this paper, concluded that *bancassurance* is illegal in Zambia but ended short of proposing a legislative framework for *bancassurance* regulation in Zambia. This research paper takes the issue up from there.

From the statement of the problem, the practical application of the study becomes evident. A regulatory framework for *bancassurance* is key not only to bring some clarity and predictability to the subject area, but arguably to bring it within the confines of the law.

Additionally, the benefits of *bancassurance*, identified above, to the consumer, the banks, the insurer and the economy also demonstrate the practical relevance of the study. For these benefits to fully come to bear on the economy, it is vital to regulate *bancassurance* meaningfully.

1.6 METHODOLOGY

The study employs the socio-legal theory approach. The object of the research paper is to propose a solution to a practical legal problem which has implications on consumers of insurance services. The problem which the study seeks to resolve has arisen because the law has not moved in tandem with innovations in commerce. The reality on the ground is far removed from the law. The study seeks to bridge the two.

The actual research work undertaken for this paper is qualitative in nature. Desk research forms the principal method of data collection. Jurisprudence from various jurisdictions has been reviewed and analysed. Legal precedents, books, articles, academic writings, presentations, the internet and other authoritative writings are equally an important source of material for the paper.

1.7 CONCLUSION

In this Chapter, a short preview into *bancassurance* and its broad nature has been rendered. The Chapter has also laid the structure of the paper and demonstrated the need for a research work around *bancassurance* regulation. Chapter two follows on to review the current regulatory arrangements for *bancassurance* in Zambia.

CHAPTER TWO – *BANCASSURANCE* IN ZAMBIA

2.1 INTRODUCTION

Banking business is often highly regulated and based on permissible activities as are set out in a banking licence. In the case of Zambia, banks are licensed under the Banking and Financial Services Act (the "BFSA"), Chapter 387 of the Laws of Zambia. It follows, therefore, and the BFSA is clear on this point, that banks can only engage in such activities as are permitted under the Act. The Author shall argue that if an activity is not specifically permitted under the licence and the BFSA - *a fortiori* if an activity is specifically proscribed by an Act of Parliament - such an activity cannot be validly and/or legally undertaken by a commercial bank.

This Chapter demonstrates that if that test were to be applied to *bancassurance*, it could possibly be concluded that *bancassurance* is illegal in Zambia. More importantly, within the context of this paper, this Chapter demonstrates the lack of specific regulations relating to bancassurance arrangements in Zambia.

2.2 THE PRACTICE OF BANCASSURANCE IN ZAMBIA

In terms of the survey undertaken in 2010 by Chilufya[15], it is evident that *bancassurance* arrangements exist in Zambia. Of a total sixteen banks licensed at the time, four were involved in *bancassurance* partnerships. Each bank was tied up with only one insurance company, although two of the banks surveyed were

[15] C. M. Chilufya, "Bancassurance Partnerships, A Missed Opportunity for Zambian Banks and Insurance Companies" (MBA Diss., Eastern & Southern Africa Management Institute/Maastricht School of Management, 2010), pp.36-40

tied up with the same insurance company (so that only three insurance companies out of a total fifteen licensed, were involved in *bancassurance*). All the *bancassurance* partnerships were with a Life Insurance company. The oldest *bancassurance* partnership dated back only four years.

All the partnerships adopted the distribution model approach and all had a distribution agreement executed between the partners. Only one of the partnerships had a detailed service level agreement setting out various processes such as sales, underwriting, policy issuance, premium collection and claims handling expectations. It also covered agreed turnaround times for the processes. Chilufya found that this latter partnership was the most successful of the lot in terms of sales, product innovation and distribution channels, although it had only been in existence for two years.

The study also revealed that of the four partnerships, the bank partner had sought out the insurance partner in three cases. In only one case had the insurance partner initiated the tie-up. The product range included mandatory credit life cover (life insurance on a loanee), funeral plan, educare plan, hospital plan and imbedded products (insurance products coupled with banking products where the cover is included in the fee for the banking product).

The distribution channels in use were branch staff, relationship managers (i.e., bank staff dedicated to particular customers), tele-sales, bank agents (i.e., commissioned contract sales personnel), insurance agents and customer referrals

2.3 THE COMMON LAW PRINCIPLE OF ILLEGALITY

It is trite law that any contract entered into contrary to a statute is illegal and unenforceable. At common law, if a statute proscribes an activity and persons enter into a contract contrary to that proscription, such a contract is illegal as formed and no legal rights can, generally, flow from it. The consequences of such illegality are that losses lie where they fall. Any monies paid by one party to the other are, generally, irrecoverable[16].

The principles surrounding Common Law illegality have often been described as one of the most confusing aspects of contract law. This is in part due to the numerous exceptions to general principles of law.[17] Suffice to say, the Author holds the view that no area of consumer service must totter on the periphery of legality. The consequences of a legal pronouncement nullifying contracts of insurance written with the intermediation of banks would be disastrous.

2.4 *BANCASSURANCE* – LEGALITY ANALYSIS

2.4.1 The BFSA

The BFSA mandates activities to be undertaken by commercial banks once they have been issued with licences. Section 8 (1) of the Act provides thus:

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[16] Valsamos Koufou v Anthon Greenberg (1982) Z.R. 30 (H.C.)
[17] A, Tufal. "*Illegality*" lawteacher.net. http://www.lawteacher.net/PDF/illegality%20Lecture.pdf)

> Except where the conditions attached to a particular licence otherwise provide, a banking licence shall be taken to authorise its holder to engage in any of the following activities in addition to banking business... (The section goes on to prescribe the permissible activities)

Essentially, therefore, and in terms of section 8 (1) above, a banking licence enables a bank to engage in two sets of activities, namely, those enumerated under that section and those that fall under the umbrella of "banking business".

In terms of section 2 of BFSA, "banking business" means any of the following:

(a) the business of receiving deposits from the public including chequing account and current account deposits and the use of such deposits, either in whole or in part, for the account of and at the risk of the person carrying on the business, to make loans, advances or investments;

(b) financial services; and

(c) any custom, practice or activity prescribed by the Bank of Zambia as banking business.

"Financial service" under the BFSA means any one or more of the following services:

[The Act enumerates 18 activities which constitute financial services and then continues thus;]

(q) Any other services as the Bank of Zambia may designate, but does not include

(1) Underwriting, marketing and administration of contracts of insurance or reinsurance; or

(2) Any service excluded from the scope of this definition by a provision of this Act or by the Bank of Zambia under this Act

In terms of the BFSA, and given that the legislator has in clear and unambiguous terms, excluded from the definition of financial services (a component of banking business), the underwriting, marketing and administration of contracts of insurance and reinsurance, *bancassurance* is, it is argued, illegal in Zambia.

A bank can only perform such activities as its licence would permit it. This is clear from the marginal note under section 8 which delineates these activities ("Authorised activities of banks in addition to taking of deposits"). These activities fall in only three categories namely;

i. those specified and specifically listed under section 8 (insurance is not one of them);

ii. Banking business as defined under section 2 (does not, and it is argued, cannot include insurance); and

iii. Financial Services. This is the only category where insurance business could possibly fall. However, it is specifically excluded under the definition of financial services. It must also be noted that although the Bank of Zambia ("BoZ"), the relevant regulator under the BFSA has power to designate financial services, it follows that BoZ cannot, technically, permit *bancassurance* because to do so would be to "designate" a financial service to be distributed/marketed by a bank which the BFSA specifically proscribes. That BoZ has permitted *bancassurance* is the gravamen of the argument for legislative reform,

Ndalameta[18] in his research on the subject of the legality of *bancassurance* comes to the same conclusion. Ndalameta concludes that it is not competent for BoZ and the Pensions and Insurance Agency (the "PIA"), the relevant Insurance Industry regulator in Zambia, to sanction *bancassurance* when the same is clearly illegal from the BFSA perspective[19]. The discussion above on the fundamentals of common law illegality, in the Author's view, renders this conclusion correct or, at the very least, plausible.

[18] **N**dalameta, "*Bancassurance: a Legislatively Premature Entry into Zambia?" (*LLB Diss., University of Zambia, 2011) *38*
[19] **N**dalameta, "*Bancassurance: a Legislatively Premature Entry into Zambia?"* 38

Whatever the wisdom is in permitting banks to engage in *bancassurance* in the light of the arguments above, there is certainly a case for clarifying the law on *bancassurance's* legality and moving an amendment to section 2 as proposed in Chapter four of this paper.

2.4.2 The CCP Act

The second illegality argument which can be canvassed relates to competition law. As noted above, Chilufya's research findings[20] point to the fact that the most frequent model of *bancassurance* in Zambia is the agency model, whereby the bank is registered as an agent of the insurance company under the provisions of section 9 of the Insurance Act[21] (the "Insurance Act"). That section provides that; "An insurance agent's licence shall allow the holder of the licence to act as an insurance agent for only one registered insurer named in the licence".

It has been argued[22] that this provision of the law, when applied to the referral, distribution agreement and joint venture *bancassurance* models, leads to the creation of a "Vertical Agreement", defined under section 2 of the Competition and Consumer Protection Act[23] (the "CCP Act") to mean "an agreement between enterprises each of which operates, for the purposes of the agreement, at a different level of the production or

[20] C. M. Chilufya, "*Bancassurance Partnerships, A Missed Opportunity for Zambian Banks and Insurance Companies"* (MBA Diss., Eastern & Southern Africa Management Institute/Maastricht School of Management, 2010) 42
[21] Act Number 27 of 1997
[22] **N**dalameta, "*Bancassurance: a Legislatively Premature Entry into Zambia?"* 6
[23] Act Number 12 of 2010

distribution chain and relates to the conditions under which the parties may purchase, sell or resell certain goods or services".

Ndalemeta[24] argues that where the bank owns an insurance company and therefore, manufactures insurance products (which it distributes through its banking business arm of the business), the effect is to create a similar and anti-competitive structure referred to as a "Horizontal Agreement", defined under section 2 of the CCP Act to mean "an agreement between enterprises each of which operates, for the purpose of the agreement, at the same level of the market and would normally be actual or potential competitors in that market".

Both Horizontal and Vertical Agreements are illegal under sections 8, 9 and 10, respectively, of the CCP Act.

The position of the Competition and Consumer Protection Commission (CCPC), the regulator under the CCP Act, in an opinion rendered to the Central Bank is to the effect that *bancassurance* is not anti-competitive *per se*[25]. This opinion remains the official position of the CCPC on the matter, on the basis that adverse market effects must be demonstrated before a conclusion of anti-competiveness is arrived at[26].

There is, in the Author's view, some merit in Ndalameta's argument on vertical agreements arising from the mandated one-bank-one-insurer tie

[24] **N**dalameta, "*Bancassurance: a Legislatively Premature Entry into Zambia?"* 6
[25] Zambia Competition Commission Response to Press Query dated 10th December 2009; http://www.postzambia.com/post_read_article_php?articleld=3214)
[26] Position confirmed by CCPC Director Legal in an interview with the Author on 5/12/12

ups. Such arrangements render it difficult for insurance companies that are not tied up to find commercial banks to align to. Research undertaken on *bancassurance* in India[27] in 2011, where similar provisions to section 9 of the Insurance Act exist, demonstrates that such a provision in the law engenders anti-competitive conduct. The one bank one insurer tie-ups mandated by regulation create unfair competition in favour of banks. New insurers are always looking for partners and banks thus have leverage to demand higher commissions from their partner insurers using the threat that they can get tied up with a new entrant. This is a double-edged sword which cuts at consumers (higher premiums) and insurers who are either held at ransom (ones already tied up) or prevented from finding partners to tie up with. Suffice to say, vertical agreements of this nature are clearly anti-competitive. This, in the Author's view, is evidence of market distortion.

As regards Ndalameta's argument on wholly bank owned insurance companies and horizontal agreements, the current provisions of section 75 of the BFSA which restrict equity ownership by a bank in any asset to a maximum of 15% and imposes other prudential thresholds on outside bank interests, entail that such horizontal agreements would not occur. In the Author's view, therefore, that argument is ineffectual.

[27] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation* (June 7, 2011); http://www.irda.gov.in/ADMINCMS/cms/frmGeneral_NoYearList.aspx?DF=Creport&mid=12) pp 34 and 35

2.5 THE CURRENT STATE OF BANCASSURANCE REGULATION IN ZAMBIA

Putting the illegality argument to one side, it is clear, and both Ndalameta and Chilufya[28] make this point, that there is no express regulation for *bancassurance* currently in Zambia. The analysis that follows in Chapter three shall show that this is a situation that requires immediate remediation.

A review of both the Insurance Act and BFSA and regulations issued under those two statutes undertaken by the Author shows that there are no express regulatory provisions relating to *bancassurance*. In fact, the PIA in licensing banks to distribute and market insurance products merely refers to the agency licensing provisions under section 9 of the Insurance Act referred to above. No other guidance exists in the two pieces of legislation and any other law on how the *bancassurance* business must be regulated.

Ndalameta[29] observes that:

> The findings herein can be generalised to the population at large. One would venture to suggest that *bancassurance* has never been in the contemplation of the legislature because the term alone nowhere appears in the Laws of Zambia. Thus, attempts on the ground to work the concept have in truth been aimed at overcoming a legal straitjacket. Observers

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[28] Chilufya, "*Bancassurance Partnerships, A Missed Opportunity for Zambian Banks and Insurance Companies"* 42

[29] M. **N**dalameta, "*Bancassurance: a Legislatively Premature Entry into Zambia?" (*LLB Diss., University of Zambia, 2011) 36

point out that where new insights find themselves bottled in old definitions, there is clearly a risk of overall inconsistency. Without parliamentary consideration of *bancassurance*, the interests of the various stakeholders like the bank, insurance company, consumer and legislator are likely to levitate in a state of imbalance. It is imperative therefore that machinery is set in motion to determine how best to incorporate into the Zambian commercial landscape, this heterogeneous concept of *bancassurance.* Such a task was always beyond the scope of this paper, but is enunciated as a recommendation at 4.3.4 below.

The undertaking to enshrine *bancassurance* into law in Zambia has yet to be done. The Zambian Central Bank, through the vehicle of the Financial Sector Development Plan (FSDP), is currently undertaking a review of financial sector laws which include the Insurance Act and the BFSA. These bills were circulated for stakeholder input in April 2012. The definition of “financial services” in the proposed BFSA still retains the prohibition against *bancassurance* related products. The proposed insurance law increases the number of insurance companies an agent may tie-up with to two (one life and one general insurance company). The new law contains no provisions which are directed at resolving the want of regulation on *bancassurance*. The problem is very much alive.

2.6 CONCLUSION

This Chapter has demonstrated that *bancassurance* is illegal in Zambia, a situation which, it is argued, requires immediate remedy. More importantly, however, the Chapter has highlighted the need for clear and express regulation on *bancassurance* in the light of the patent absence of such regulation. In the following Chapter, an analysis of the legislative landscape for *bancassurance* in Europe, Asia, the Americas and the Middle East is undertaken. The intention of this analysis is to glean from it, best practice which can be replicated in Zambia and propose a model framework for regulation in Zambia, the ultimate object of this paper and the subject of Chapter four.

CHAPTER THREE - A COMPARATIVE ANALYSIS OF

***BANCASSURANCE* REGULATION**

3.1 INTRODUCTION

Bancassurance has, since the 1970's, grown in primacy as a means of distribution of insurance products the world over. Its penetration varies in different regions around the globe. Europe, and in particular Italy, Spain and France, leads the way in terms of *bancassurance* penetration. Asia, Africa and the America's have fallen behind due, in large part, to regulatory restrictions there. Asia, particularly India and China, has, however, recently emerged as a hotspot for *bancassurance* owing to regulatory relaxations in that region.[30]

Chapter 3 presents a case study on regulatory trends around the world. Its ultimate objective is to glean from the global experience, regulatory best practice which can be replicated in Zambia in the development of regulations for *bancassurance*. The approach taken is a simple one. Various regulatory issues pertaining to *bancassurance* are discussed in turn, from a global perspective.

3.2 CASE STUDY APPROACH

Bancassurance regulation, as the discussion below shall demonstrate, poses various challenges and opportunities for industry players, consumers and regulators. The various regulatory issues identified below are analysed from a

[30] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation* (June 7, 2011), http://www.irda.gov.in/ADMINCMS/cms/frmGeneral _NoYearList.aspx?DF=Creport&mid=12)

multi-jurisdictional perspective. The recent experience in India where a specialist committee investigated and made recommendations on how best to regulate *bancassurance* in India makes India an ideal source of inspiration for this chapter. The parallels between the Indian and Zambian legal regime (both share common law roots and similar jurisprudence) justifies the heavy reliance on the Report of the Committee on *Bancassurance* Regulation constituted by the Insurance Regulatory and Development Authority (IRDA) of India. Notably, the Indian Report presents a global comparative study of *bancassurance* regulation and its conclusions are representative of global trends.

The experience of other jurisdictions from Europe, Asia, the Middle East, North and South America is also drawn on, and the issues raised, analysed in the sections that follow. The paper is also greatly informed by the findings of the policy research undertaken by the World Bank[31], on *bancassurance* globally. The World Bank has clearly guided that due to the inherent complexities of insurance products, the predominant position that a bank can take in a banker-customer relationship and in order that the real benefits of *bancassurance* come to bear in any market:-

> It is therefore crucial that Bancassurance is used as a development tool in a context in which there is careful regulation of the activities of the lender. This paper explores the strategic aspects of the positive value

[31] Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*."

opportunities, while at the same time examining methods to avoid the pitfalls, of using Bancassurance as a development tool[32].

3.3 REGULATORY ISSUES

Discussed below are various issues which would arise in the regulation of *bancassurance*. The discussion draws current regulatory frameworks from around the world with examples of live regulatory problems that have arisen in various jurisdictions, and proposed solutions to the problems peculiar to the subject area of regulation.

3.3.1 *Bancasssurance* Models

One of the key issues that *bancassurance* regulations must address is the *bancassurance* distribution models which are permissible.

A review of the European regulatory landscape shows that *bancassurance* has adapted to three main models as follows; simple commercial distribution agreements on an exclusivity basis, joint ventures coupled with exclusive distribution agreements and the fully integrated model where a bank wholly owns an insurance company which acts as its *bancassurance* partner[33].

A fourth model known as open architecture has been migrated into Europe from the USA. This model, which originated in the USA after the Glass - Steagall Act,

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[32] Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*.", 7

[33]BNP Paribas Cardif, *"Bancassurance Models Worldwide"*; http://www.bnpparibascardif.com/ en/cid3191619/*bancassurance*-models-worldwide.html.)

prohibited banks from owning equity in insurance companies on the back of the 1929 Wall Street crash, is characterised by nonexclusive, multi-insurer partnerships with the same bank. In this model, bank networks distribute the products of multiple insurer partners[34]. As noted below on the Asia discussion, the model has also grown in South Asian markets, including Japan, Korea, China and Taiwan.

The Asian landscape has, in recent years, been characterised by a *bancassurance* distribution model based principally on open (or semi-open) architecture, with banks primarily distributing insurance products marketed by a range of different suppliers. The recent trends, however, have seen a discernible growth in the more integrated models (joint ventures and wholly owned subsidiary models). The Chinese experience is summarized in the excerpt below[35].

> In China, for example, the *bancassurance* regulations introduced in 2003 triggered a real boom in over-the-counter sales of insurance policies by bank branches. Some major banks use up to 30 different suppliers for life insurance, and as many as 10 for property and casualty insurance. However, the Chinese regulators have recently made it possible for major banks to take majority shareholdings in insurance companies. This development could change the market significantly.

Recent regulatory developments in India have also gravitated towards a variant of the open architectural model. In as far as current law and policy in India goes,

[34]Ibid
[35]Ibid

an insurance company can only tie-up with one bank as a *bancassurance* partner. In terms of the one bank one insurance company (one life and one non-life) policy, the bank acts as the agent of the insurance company. The Indian Insurance regulator, the Insurance Regulatory and Development Authority (IRDA), issued draft regulations in 2012 which seek to increase the flexibility of banks and insurance companies in so far as the mandatory one bank one insurer tie-up policy is concerned[36].

In the proposed arrangement, banks would sell insurance products as agents of the insurer. Since the law requires that the agency model be limited to the one bank and one insurer structure, the IRDA seeks to introduce a semi-open architectural model where India will for this purpose be categorised into three zones; A, B and C, with each Zone constituted by different locations (States/Union territories). Under the proposed rules, a bank can at the most tie-up with a particular life, non-life and health insurance company in a maximum 20 and minimum 10 locations. For the remaining areas it will have to seek different partners. This shall entail that even banks with their own insurance entities will require to tie-up with other insurance companies[37].

The IRDA has expressed the view that open architecture without geographical divisions would not only contravene current law requiring one insurer to one bank tie-ups but would also have little meaning since smaller players will

[36]The IRDA Draft Regulations came on the back of the recommendations contained in the Report of the Committee on *Bancassurance* (see note 21 above)

[37] Daily News and Analysis (DNA) India, "*IRDA Goes Flexible in Draft Regulations on Bancassurance",* Money; http://www.dnaindia.com/money/report_irda-goes-flexible-in-draft-regulations-on-*bancassurance*_1750394

continue to be neglected, a clearly pertinent argument in so far as fair competition is concerned [38].

The Indian Committee on *Bancassurance* has, additionally, proposed that the referral model, where the bank merely supplies leads and/or access to its data base to the insurer be outlawed in India, as it ultimately works out less efficiently and more expensive to the consumer [39].

The World Bank proposes that *bancassurance* has developed slowly in markets where regulation places restrictions on the ability of banks to have cross shareholding in insurance companies. The United States of America, Canada and China are cited as examples. [40]

On the issue of whether or not the law must permit multi-insurer tie-ups with one bank, it is an open question how best to address the customer's choice of insurers. If a bank or other agent offers the consumer only a single insurer, the customer should rightly be concerned whether he or she is being offered the best product at the best price. Choice is at the heart of healthy practice. The World Bank recognises that this is in no way a simple question but concludes that a panel of insurers is strongly likely to deliver the healthiest outcome to the consumer. The Regulator may wish to go further and issue regulations which

[38] Ibid

[39] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation*, 45

[40] Gonulal, N Goulder and R Lester, "*Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*.", 22

ensure that banks do not slant there sales pitch in favour of one insurer in the spirit of a fair sales process. [41]

Turning to the United Arab Emirates ('UAE'), until 2011, *Bancassurance* was unregulated. In a Circular issued by the Insurance Authority in September 2011, a number of areas have been clarified. The Circular is, however, a temporary measure pending promulgation of the Draft Resolution on *Bancassurance* which the Insurance Authority is in the process of issuing. Notably, however, the Circular contains provisions similar to the expected legislation[42].

The new regulations in the UAE do not limit the number of *bancassurance* partnerships a bank may enter into. However, a bank may only market an insurer's policies in the Emirate where the insurer has a presence through branches, and in which it is authorised to settle claims. This forces a semi-open architectural model on *bancassurance* partnerships in the UAE[43].

The discussion on *bancassurance* models is pertinent to a number of factors which determine the efficacy of *bancassurance*. The competition environment, the cost of premiums and level of commissions, the range of products distributed through *bancassurance* and whether or not banks are permitted to deploy excess liquidity in insurance subsidiaries are all dependent on the permissible models. If the law, as is the case in Zambia, only permits a bank to tie-up with one insurer,

[41] Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*.", 25

[42] Clyde & Co LLP http://www.clydeco.com/insight/updates/*bancassurance*-regulations-update (accessed 24/10/12)

[43] Ibid.

the premiums are bound to be high, the ability of other insurers to tie-up drastically impaired, commissions exorbitant and the product range very limited (since an insurer in Zambia can only sell either life or general insurance and never both). Most of these issues exist in Zambia. The models which promote fair competition enhance the number of products offered to consumers and drive down the ultimate cost of such insurance to the consumer must, it is argued, be preferred

3.3.2 Consumer Protection and Fair Treatment of Customers

A review of regulatory trends around the world reveals that the development of customer value and consumer protection is a key theme. The two examples below highlight the point. The first of these relates to the Chilean experience.

> The terrible earthquake of February 27, 2010 triggered more than 200,000 claims. However, the dissatisfaction of claimants with the service they received and the time taken to obtain payment raised governmental concerns over the margins made by banks, which were judged to be 'not transferred' to consumers. The new regulation introduced with effect from 2011 controls not only the prices charged for insurance, but also prohibits banks from accessing commissions on certain insurance products, and specifically those related to loans. This example illustrates the fact that regulation has provoked responses to consumer expectations. Over and above improving the claims handling procedures highlighted as defective in 2010, the people of Chile wanted greater clarity in their

> policies and less paperwork, as well as information about commissions and conditions of sale in order to make up their own minds whether the insurance policy was really suitable for their needs[44].

The second example is from Poland[45].

> *Bancassurance* agreements (i.e. arrangements under which banks distribute to their customers insurance products issued by particular insurers) have recently come under scrutiny in Poland and the Insurance Ombudsman has requested that the Polish FSA and the Polish Antimonopoly Office examine whether Polish *bancassurance* agreements comply with Polish laws. We are aware of a number of cases in which formal proceedings have been initiated by the Polish Antimonopoly Office although we have not yet come across formal proceedings being initiated by the Polish FSA against any counterparty to a *bancassurance* agreement.

BNP Paribas Cardif[46] in their analysis of global trends in *bancassurance* regulation point out that regulators have generally been concerned with three issues in the area of consumer protection, namely the lack of clarity on the attributes and benefits of products, the absence of transparency in premium

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[44]BNP Paribas Cardif, *"Regulation of bancassurance: an opportunity to develop customer value";* http://www.bnpparibascardif.com/en/cid3191302/symposium-1.html
[45]Linklaters.com, "*Increased Scrutiny of Bancassurance Agreements in Poland"* Insurance Update (31st January 2012); http://www.linklaters.com/Publications/Publication1386Newsletter/insurance-update-January2012/Pages/Increased-Scrutiny-of-*Bancassurance*-Agreements-Poland.aspx
[46]BNP Paribas Cardif, *"Regulation of bancassurance: an opportunity to develop customer value"*

quotations, and the want of differentiation between the insurance and the financial product (a loan say) in marketing insurance products.

BNP[47] note that in addition to consumer protection, regulators have also insisted that the products sold to customers must be adapted to meet their particular situation and needs. In this respect the following key areas of focus in national regulatory frameworks are highlighted;

- improving the information provided to end-user customers by banks;
- requiring that banks are more transparent in terms of premium quotations, eligibility and exclusion criteria, extent of cover and other pertinent aspects of the insurance being sold;
- leaving the consumer free to choose the identity of the insurance distributor. The bank must not force the customer to take insurance only from its partner insurer(s). The World Bank goes even further and proposes that it would be sensible for the consumer to be required to sign to acknowledge that they have been given this choice via a clear statement such as – "I am aware that I have a choice as regards the insurer and that I am free to change insurer after the first 12 months"[48];
- being more responsive in the handling of complaints and management of disputes;

[47] Ibid
[48] Gonulal, N Goulder and R Lester, **"***Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*.", 25

- making insurance distinctive as a voluntary/personal process and adapting mixed ranges of products to suit customers;

- developing a closer relationship with consumers by communicating the intrinsic value of the product and the consumer benefit it delivers. (The Committee on *Bancassurance* in India for instance recommended that to prevent mis-selling, all insurance products that are imbedded into a financial product (as for instance credit life insurance on contracting a loan) be explained to the customer. Equally, a suitability or needs assessment must be undertaken before an insurance product is sold to a customer)[49].

The following excerpt sums up the issue aptly[50];

> A greater focus on consumer protection in terms of products offered, information supplied, advice and every stage of the sales process is a major international trend in *bancassurance*…. As a result, it is reasonable to expect that increasing pressure will gradually be imposed on *bancassurance* providers to ensure greater vigilance. The regulatory Authorities in many countries have already put in place measures to counter certain abuses in the selling of financial products and provide greater protection for consumer freedom of choice, introduce greater visibility and transparency of covers and commissions, and draw clearer

Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation* 44

[50]BNP Paribas Cardif, *"The forward development of bancassurance against a background of tighter consumer protection";* http://www.bnpparibascardif.com/en/cid3191655/the-forward-development-*bancassurance*-against-background-tighter-consumer-protection.html

distinctions between the sales processes for financial products (like loans) and the (insurance) products used to cover them.

It must be noted that these trends on consumer protection are not alien to Zambia. Regulatory focus in Zambia, particularly in the recent past has gravitated towards consumer interest, and rightly so. Banks have been compelled to reduce the interest rates charged to customers and the CCPC has launched investigations on allegations such as collusion in setting of bank interest rates in the industry. It is imperative that international best practice on consumer protection related *bancassurance* issues be replicated.

Insurance contracts are technical and complex. The process around selling insurance, particularly through intermediaries of insurers, must be undertaken with great care and the interests of the consumer must always be paramount.

3.3.3 Types of Insurance which may be Sold

The Indian model does not place a restriction on the types of insurance which may be sold. Life, non-life and health insurance may be distributed using the *Bancassurance* model. Both personal and commercial lines of cover may be sold[51].

In terms of the Circular issued by the Insurance Authority in the UAE, only insurance products which augment financial products or are reasonably incidental to the enjoyment of the financial product can be sold. As such, the Circular

[51] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation*, pp 25-7

stipulates that the following policies can be written; *"Housing loans and related insurances, credit, personal loans, credit cards insurance and similar types of insurance such as involuntary loss of work and wallet insurance (the insurance covering the loss or theft of the wallet holding credit cards, ID, keys, money and covering health care costs resulting from injuries suffered at the time of wallet loss or theft)*[52] *."*

Notably, these are personal lines of cover. Commercial lines are not permitted to be sold through banks.

The trend in Europe is for bank branch staff to sell a growing number of insurance products that are becoming further removed from the bank's core business. These would include protection, health, or non-life products. As most branch staff are not usually trained to sell insurance, most of the products are designed specifically for *bancassurance* channels to meet the needs of branch advisers in terms of simplicity and similarity with banking products [53].

Unless there is basis for restricting the range of products competent to be sold through the *bancassurance* model, and there appears to be none, it is desirable that all forms of cover be sold. The benefits of promoting risk transfer through insurance in any economy cannot be overemphasised. In any event, the essence of *bancassurance* is to increase the distribution network for insurance products. Restrictions on the classes of cover cannot be justified. The rider, naturally, is

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[52] Clyde & Co LLP
[53] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation*, 10

that complex forms of cover must be sold by qualified persons, a point canvassed in the section that follows.

3.3.4 Licensing and Training of Bank Staff

In terms of current Indian law (IRDA (Licensing of Insurance Agents) Regulations 2000),[54] as well as the Indian draft regulations on *bancassurance*,[55] the IRDA requires that one member of bank staff (known as a 'specified person') must be licensed by the IRDA to solicit or procure insurance business. Such an individual must have passed the IRDA insurance distributor licensing examinations. A specified person can only supervise a limited number of branches (up to a maximum of 5). A Specified Person is also to be made accountable for any malfeasance or misfeasance which occurs in branches in terms of the Indian Insurance Act and code of conduct for Specified Persons.

As regards the UAE, the Circular issued by the Insurance Authority requires a bank which distributes insurance products to have in its employ a suitably trained member of staff capable of explaining the key attributes of the insurance cover to bank customers. The Circular does not define 'suitably trained'. The Circular also requires that the insurance company train bank staff selling insurance products[56].

[54] *Ibid*, 44
[55] Mulliman, *"Draft Regulations on bancassurance in India"*. Asia E-Alert (7 December 2011); http://publications.milliman.com/publications/life-published/pdfs/asia-e-alert-draft-regulations-*bancassurance*.pdf
[56] Clyde & Co LLP

Regulations in Europe differ from country to country in this respect. In the United Kingdom and Germany for instance, insurance products must be sold by a regulated sales person, rather than by counter staff. This is not the case in France and Spain where an unregulated person may sell insurance[57]. Even there, however, branch staff are supported by specialised insurance advisers for more sophisticated products and insurance products are sold by selected branch staff members who are given appropriate product training[58].

As already noted, the nature of insurance is such that it is subject to complex legal rules and principles. In order that the consumer is accorded an opportunity to have the product they are purchasing explained to them as competently and as comprehensively as possible, it follows that a level of knowledge is expected of the person to supply such explanation. To avoid mis-selling, it is imperative that the law prescribe the minimum qualifications to be held by key bank staff involved in the *bancassurance* undertaking. The Indian approach is laudable in this respect.

3.3.5 Who Regulates

Bancassurance brings together two separate regulatory aspects of commerce, namely banking and insurance. The key question is this; who regulates *bancassurance*?

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[57] Colette Dunn, "*Bancassurance*: *lessons from the past*". Towers Watson; http://www.watsonwyatt .com/europe/pubs/insurancefinancial/render2.asp?ID=10738

[58] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation* 10

The Indian model provides a useful construct. The Report on *Bancassurance* Regulation provides an apt summary of the Indian regulatory model.

> In India banking and insurance sectors are regulated by two different entities. The banking sector is governed by Reserve Bank of India and the insurance sector is regulated by Insurance Regulatory and Development Authority (IRDA). *Bancassurance* being the combination of two sectors comes under the purview of both the regulators. Each of the regulators has come out with detailed guidelines for banks getting into the insurance sector[59].

The question which follows from this is; where does the regulatory ambit of one regulator end and the other's begin? To answer this question, it is necessary to look into some detail at the regulations issued by each of the two Indian Regulators.

In this regard, the RBI issued guidelines for banks wishing to engage in insurance business in 2000, the year that it permitted *bancassurance* in India. In terms of the RBI guidelines of 2000, a commercial bank was permitted to undertake insurance business as an agent of an insurance company, or through equity participation in a joint venture with an insurer, provided that a bank could not hold more than 50% equity in the joint venture without RBI prior approval.

[59] Ibid, 28

RBI prior approval is not necessary for the agency and referral models (i.e. where there is no risk/equity participation by the bank[60]).

In other guidelines, banks are now expected to disclose the commission they receive from an insurer to the customer to drive transparency. Banks are also mandated to disclose vide a line in the profit and loss account, the total earnings they have made from insurance distribution[61].

The IRDA, on the other hand, regulates three main areas, namely conditions under which a bank can act as a corporate agent of an insurer, rules that apply to referral model arrangements, and the prohibition of banks to act as an insurance broker. An "Insurance broker" means a person who for remuneration arranges insurance contracts with insurance companies and/or reinsurance companies on behalf of his clients. The law requires that a broking company must not engage in any other business other than insurance brokering. Agents on the other hand are by regulation tied to one insurance company and are recognized as representatives of the insurance company[62].

There is a clear danger of cross regulation here. Care must be taken to delineate the respective regulatory ambit of the two regulators. In the Author's view, the key lies in ensuring that the issues that are principally of an insurance nature must be regulated by the insurance regulator, whereas the issues that are banking related must be regulated by the banking regulator. In the scheme of things, the insurance regulator will have some

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[60] Ibid, 29
[61] Ibid
[62] Ibid, pp 29. 30 and 33

oversight even over the bank partner, while the bank regulator will not have any jurisdiction over the insurance company. The two regulators must also collaborate in coming up with the regulatory framework.

3.3.6 Commissions and Fees

It is generally desirable that the amount of commissions paid to banks by insurers be capped in one way or another. Research undertaken by the Committee on *Bancassurance* in India demonstrates an upward trend in the amounts paid by insurers to banks year-on-year from 2000 to 2010 by way of commissions[63]. Three main reasons have been cited for the increase;

- Competition among insurers to secure partner banks leading to higher commissions offered to maintain relationships;

- The one bank one insurer tie-ups mandated by regulation creates unfair competition in favour of banks. New insurers are always looking for partners and banks thus have leverage to demand higher commissions from their partner insurers using the threat that they can get tied up with a new entrant;

- Prior to 2010, banks and insurers circumvented the requirement that corporate agency and referral models were mutually exclusive in terms of IRDA regulations. As such, banks were paid for referrals in addition to commissions on their agency roles. (The "Sharing of Database for Distribution of Insurance Products" regulations 2010 curtailed this practice).

[63] Ibid, pp 34 and 35

Suffice to say, higher commissions translate into higher premiums and defeat one of the key benefits of *bancassurance*, namely to provide cheaper insurance options for consumers by reducing the usual distribution costs. Given that research in Europe and Asia has shown that the cost of the policy to the policyholder as well as to the insurer is lower under the *bancassurance* channel than under all the other distribution channels, regulators have generally to keep an eye out and ensure that the benefits trickle down to the consumer and are not obliterated by excessive commissions and 'other expenses'[64].

As such, current regulations in India, for instance, provide for disclosure of commissions as noted above. In the draft regulations circulated by the IRDA[65] following the recommendations of the Committee on *bancassurance* it is proposed that;

- Remuneration to banks for insurance tie-ups is limited to commissions only. No other payment is permissible. As such, reimbursement of expenses for advertisements, training or prizes for staff incentive competitions is impermissible;

- Commissions be capped to a maximum amount;

- All cash and non-cash benefits are to be valued at arm's-length and treated as advance commission payments to be reckoned in determining whether the maximum threshold has been breached.

[64] Ibid, pp 40-43
[65] Mulliman, *"Draft Regulations on bancassurance in India"*

These proposals are all very clearly progressive.

3.3.7 Code of Conduct

A clear take away from the Indian regulatory regime is the requirement for a code of conduct to regulate the activities of the bank partners in *bancassurance*. In the case of insurance agents (a position which banks assume in the agency model) the IRDA (Licensing of Insurance Agents) Regulations, 2000 prescribe the code of conduct to be followed by insurance agents. The following aspects of conduct are regulated[66];

(a) requirement that the agent identify himself and the insurance company of whom he is an insurance agent;

(b) disclosure of license to the prospect on demand;

(c) dissemination of the requisite information in respect of insurance products offered for sale by his insurer and taking into account the needs of the prospect while recommending a specific insurance plan;

(d) disclosure of the scales of commission in respect of the insurance product offered for sale, where requested for by the prospect;

(e) indication of the premium to be charged by the insurer for the insurance product offered for sale;

[66] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation*, 36

(f) advice given to every individual policyholder to effect nomination, assignment, change of address or exercise of options, as the case may be, and offer of necessary assistance in this behalf, wherever necessary.

Although the prescriptions to be contained in a code of conduct are similar to the substantive provisions of the law which may form part of the consumer protection aspects, the Author holds the view that the code of conduct brings the regulations closer to the licensed persons and the apparent repetition is justifiable. There is ample precedent for this practice, a case in point in Zambia being the Securities Act[67]. The Securities (Conduct of Business) Rules prescribe a code of conduct for licensed persons under that Act. The provisions in the code are similar to substantive provisions under the Act.

3.3.8 Other Regulatory Issues

(a) Accounts and Record Retention

The recommendations of the Committee on *bancassurance* from their global study is that all Banks and insurers must prepare separate audited financials to be presented to regulators with other returns annually[68]. A ten year retention period for business records has been proposed in the IRDA draft regulations[69].

[67] Chapter 354 of the Laws of Zambia

[68] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation*, 43

[69] Mulliman, *"Draft Regulations on bancassurance in India".*

(b) Ombudsman System

An Ombudsman system has been set up in India to manage the complaints on mis-selling (such as would occur when the product specifications and attendant risks are not explained to policyholders) as well as settlement of any disputes between customers and the insurance company/bank.

(c) Policy Servicing

The roles of the two partners must be clearly set out as regards providing necessary services such as obtaining the duplicate policy documents, change of address, revival or renewal of policies, change of nominee, timely remittances of premium, etc. The Committee[70] recommends that a detailed Service Level Agreement (SLA) detailing the parameters to be met by the bank be mandated by law. Essentially, the banker shall accept the applications, process them initially and transmit to both insurer and policyholder.

(d) Claim Settlement:

This subject is usually the preserve of the agreement between the partners. However, as is recommended by the Committee on *Bancassurance*, [71] it may be prudent to legislate minimum standards such as the role that the bank plays in processing the claim and the time it takes to assess and pay out a successful claim.

(e) KYC and Customer Due diligence

[70] Insurance Regulatory and Development Authority of India, *Report of the Committee on Bancassurance Regulation*, 44
[71] Ibid, 43

Anti-Money Laundering obligations around the world require that players in the financial services industry conduct Know Your Customer checks at inception of the relationship with a customer and all through its course. As far as *bancassurance* is concerned, regulations in Singapore, the United Kingdom, Australia and India, among others, permit the insurer to rely on the due diligence and KYC carried out by the bank for its existing banking relationships, with the rider that the insurer must undertake periodic secondary checks through sample reviews[72].

3.4 CONCLUSION

Key to note from the discussion in this chapter is the fact that regulation is necessary to manage the complex relationships that *bancassurance* partnerships and product offerings present. The theme of these regulations, as the trends have shown, is consumer focussed. In the final chapter, the paper shall propose, from the discussion so far, a regulatory model which suits the Zambian situation.

[72] Ibid, 45

CHAPTER FOUR – CONCLUSIONS AND RECOMMENDATIONS

4.1 INTRODUCTION

Given the findings in Chapter two of this paper, there is a clear and present need for the development of regulation in and around the area of *bancassurance* in Zambia. This Chapter proposes the framework which such regulation may take, borrowing from the case studies undertaken in Chapter three hereof. The approach mirrors the general themes adopted under Chapter three and makes recommendations *vis-a-vis* the regulatory issues identified in that Chapter.

4.2 CONCLUSIONS AND FINDINGS

Referring to the objectives of the study in Chapter one, and following from the discussion in Chapters two and three, the Author has formed the following conclusions and reached the findings summarised below, namely that;

(a) *Bancassurance* arrangements engender insurance and are critical to enhancing the distribution networks of insurance companies;

(b) *Bancassurance* is technically illegal in Zambia;

(c) *Bancassurance* is not the subject of specific, stand-alone regulations in Zambia; and

(d) There is a clear and present need for an overhaul of the regulatory framework pertaining to *bancassurance* in Zambia.

In the light of the above conclusions and findings, this Chapter shall proceed to propose a regulatory model for *bancassurance* in Zambia.

4.3 PROPOSED GENERAL REGULATORY FRAMEWORK

The regulatory geography in the Indian system is quite similar to that obtaining in Zambia at the moment. *Bancassurance* is regulated dually by the Bank of Zambia (BoZ) and the Pensions and Insurance Agency (PIA). The Indian system, as noted under Chapter three, also maintains the dual regulatory system. It is proposed that this be maintained in Zambia.

Specifically, it is recommended that the Central Bank (through the due legislative process) amend the Banking and Financial Services Act to remove the prohibition against *bancassurance* in section 2 of that Act under the definition of "financial service", and include under section 8, the "underwriting, marketing and administration of contracts of insurance or reinsurance" among the enumerated permissible activities for a holder of a banking license issued under that Act. It is further recommended that the Central Bank issue specific Regulations under the Banking and Financial Services Act to regulate the conduct of the bank partner in *bancassurance* partnerships. This chapter shall make recommendations on the content of such regulations in turn under the various sections which shall follow

It is further recommended that the PIA issue detailed guidelines under the Insurance Act to prescribe various aspects of the conduct of insurance business from a *bancassurance* perspective. The context shall, again, be suggested in the sections which follow.

Both Regulators are currently undertaking review of their respective laws under the Financial Sector Development Plan spearheaded by the Central Bank. The draft Banking and Financial Services and Insurance Acts circulated contain no reference to *bancassurance* as a word or a concept.

Discussed below are the specific recommendations on regulatory content.

4.4. PROPOSALS FOR REGULATION

4.4.1 *Bancassurance* Models

It is proposed that three models be permitted under the law as follows;

(a) Open Architectural Model based on Agency

In this model, bank networks distribute the products of multiple insurer partners through nonexclusive multi-insurer partnerships with the same bank. This model avoids the anti-competitive veneer of the current situation where, the Insurance Act under section 9 (2) limits Agency arrangements to one bank one insurance partner tie-ups. It is proposed that a proviso be written into that section to exempt *bancassurance* bank partners from its application.

The action required to achieve this result is an amendment to section 9 (2) of the Insurance Act, in order that the limitation on the number of insurance companies a bank may tie-up with is made unlimited. Should the PIA see fit to retain the one-agent-one insurance company rule outside *bancassurance,* a proviso can be written into section 9 (2) carving out an exception for *bancassurance* agents.

(b) Joint Venture

Equity joint ventures between an insurance company and a bank, coupled with exclusive distribution arrangements have proven to be one of the most effective distribution models in Europe. It is recommended that this model be permissible in Zambia. Such a model would require an exception to section 75 of the Banking and Financial Services Act which limits equity ownership by banks in any asset to a maximum threshold of 15%. That section also limits equity investments by banks to a maximum of 25% of regulatory capital (circa USD25 million at present).

It is proposed that section 75 be amended to give the Central Bank latitude to approve an equity investment by a bank where the liquidity levels of the bank permit such investment. Section 75 (5) of the BFSA currently provides that subsection (1) of section 75 which imposes the 15% maximum equity investment does not apply to an investment or investments by a bank in the shares of its subsidiary, if the aggregate of all investments by the bank does not exceed 25% of its regulatory capital. The following words could be added to the end of that sub section; "or such higher threshold as the Bank of Zambia may approve". This would leave a door open, which can be clarified, as far as *bancassurance* is concerned, in the proposed Central Bank regulations.

(c) Fully Integrated Model

In this model, a bank wholly owns an insurance company which acts as its *bancassurance* partner. This model also requires amendment of section 75 of the Banking and Financial Services Act as in (b) above.

The broker and referral models are not recommended for adoption. The difficulty with the broker model is that an insurance broker must not undertake any other business and banks cannot thus be brokers. The referral model, where the bank merely generates leads which are passed on to the insurance partner is discouraged because it does not usually bring with it the added benefits of cheap products to the end-user.

As the Reserve Bank of India (RBI) has done, it is proposed that the Central Bank prescribe the means of participation in *bancassurance* by a bank. Once the guidelines have permitted the setting up of *bancassurance* partnerships (and it is proposed that they expressly do so) it is recommended that Central Bank approval be dispensed with for the agency model. This model shall be sufficiently covered under the Insurance Act agency provisions as noted above. Any form of equity based *bancassurance* model (joint venture and fully integrated models) must be made subject to Central Bank prior approval, as the proposed amendment to section 75 (5) would mandate. The rationale for this is a basic one; banks' liquidity ratios must remain healthy and parallel businesses may render a bank susceptible to collapse, putting depositors' funds at risk and posing a danger of systemic risk on the financial services industry. The parameters of risk/equity participation must be closely regulated and an equity participation threshold set.

4.4.2 Consumer Protection and Fair Treatment of Customers

It is recommended that provisions in the insurance regulations adopted by the PIA require that:

- banks provide all relevant information to end-users regarding the insurance products sold. This is critical as insurance contracts are contracts of the utmost good faith. A policy can be voided for want of disclosure;

- banks must provide written disclosures of premium quotations, proposed commission, eligibility and exclusion criteria, extent of cover and other pertinent aspects of the insurance being sold;

- the consumer is free to choose the identity of the insurance distributor. The bank must not force the customer to take insurance only from its partner insurer(s). In this regard, an "opt in" rather than an "opt out" clause in application forms must be mandated so that the choice is a real one. (for instance, in an application form for a mortgage with an imbedded insurance product, the customer must tick a box to use the bank's partner, rather than tick a box not to use that partner – in the latter case, the customer will use the partner if the box is not ticked);

- A complaints management procedure must be mandated. Optionally, the complaints procedure prescribed under section 48 of the Banking and Financial Services Act can be adopted by reference;

- Insurance offerings are sold distinctively as voluntary products. To prevent mis-selling, regulation must provide that all insurance products that are imbedded into a financial product (as for instance credit life insurance on contracting a loan) be explained to the customer. Equally, a suitability or needs assessment must be undertaken before an insurance product is sold to a customer;

- Complex products are sold by well trained and qualified persons.

The provisions proposed above may also be prescribed in regulations which govern the conduct of insurance agents generally. The key is to ensure that these regulations are passed, and that where the requirement is *bancassurance* specific, those regulations clearly map out the obligations of the two partners.

4.4.3 Types of Insurance which may be Sold

It is recommended that there be no limitation on the types of insurance which may be sold. Both life and non-life (general) insurance ought to be capable of distribution through *bancassurance* arrangements. Currently, a bank can only tie-up with one insurer. Given that an insurance company can only be either life or non-life (and not both) in terms of the Insurance Act, a bank can, therefore only distribute either life or non-life products. The recommended amendment to write a proviso to section 9 (2) will cure this. The permissibility of all insurance products can be contained in the insurance regulations issued by the PIA as proposed.

4.4.4 Licensing and Training of Bank Staff

Since insurance contracts are highly technical in nature, it is ideal that the canvassing should be done only by appropriately qualified persons engaged by the bank. As such, it is recommended that the PIA regulate a requirement for a person licensed to solicit and procure insurance business. Every bank must, at the outset, employ one such person to supervise the insurance undertaking in the bank. All bank staff selling insurance products must be trained by the licensed person to ensure compliance with the requirements of the PIA and Central Bank regulations. Such licensed person shall be made accountable for any malfeasance or misfeasance which occurs in Bank branches.

It is proposed that a licensing criterion be developed. The current provision of section 16 (2) of the Insurance Act merely requires that a corporate agent's managers and employees must have suitable qualifications and experience. This is far from sufficient. The relevant qualifications (as for instance a Bachelor of Arts degree or other academic or professional qualification from a recognised or accredited institution) ought to be specified.

4.4.5 Commissions and Fees

As noted in Chapter three, the *raison d'être* for *bancassurance* is cheaper insurance to the consumers. To achieve this, the area of commissions must be closely regulated. As such, it is recommended that:

- Remuneration to banks for insurance tie-ups is limited to commissions only. No other payment is permissible. As such, reimbursement of expenses for advertisements, training or prizes for staff incentive competitions and other promotions must be impermissible;

- Commissions must be capped to a maximum amount calculated as a percentage of the premium and globally as a maximum annual total weighted against the premium revenue made by the insurer from the partnership;

- All cash and non-cash benefits are to be valued at arm's-length and treated as advance commission payments to be reckoned in determining whether the maximum threshold has been breached. This is particularly relevant for equity participation models;

- The bank must disclose to the customer, the amount of commission to be made on any prospective policy;

- The bank must disclose to the Central Bank and the PIA the total amount made annually in commissions and the total premium revenue generated.

The regulations on commissions must be contained in the Central Bank Guidelines.

4.4.6 Code of Conduct

It is recommended that in addition to specific regulations for corporate insurance agents issued by the PIA and the Central Bank, a detailed Code of Conduct for the Bank partner in a *bancassurance* partnership be legislated. At the minimum, the following issues must be provided for;

(a) the agent's representative must identify him/herself and the insurance company of whom s/he is an insurance agent;

(b) the agent must disclose the license to the prospect on demand;

(c) the agent must disseminate the requisite information in respect of insurance products offered for sale by the insurer;

(d) the agent must take into account the needs of the prospect while recommending a specific insurance plan;

(e) the agent must disclose the scales of commission in respect of the insurance product offered for sale, if asked by the prospect;

(f) the agent must indicate the premium to be charged by the insurer for the insurance product offered for sale;

(g) the agent must advise every individual policyholder to effect nomination, assignment, change of address and exercise of options, as the case may be, and offer necessary assistance in this behalf, wherever necessary;

As these are insurance issues, they can properly sit in the PIA guidelines. As noted in regard to the consumer protection section, such a code can be one of general application to insurance agents.

4.4.7 Other Regulatory Issues

(a) Policy Servicing and Claims Management

It is recommended that the law mandate a Service Level Agreement (SLA) between the bank and the insurer detailing the parameters to be met by the bank. As a minimum, the SLA must deal with the roles of the two partners as regards providing necessary services such as obtaining the duplicate policy documents, change of address, revival or renewal of policies, change of nominee, timely remittances of premium, processing of claims and the time it takes to assess and pay out a successful claim. It is proposed that the PIA guidelines require that the Regulator must vet and approve all such SLAs.

(b) KYC and Customer Due Diligence

It is recommended that the PIA regulations permit the insurer to rely on the due diligence and KYC carried out by the bank for its existing banking relationships, with the qualification that the insurer must undertake periodic secondary checks through sample reviews.

4.5 CONCLUSION

Given the inadequacy of the current legislative framework, the recommendations in this Chapter take on a peculiar urgency. The point cannot be overemphasised that the consumer ends up suffering detriment when regulations are weak. As such, these recommendations require action sooner rather than later.

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