Community
Bank Director

May/June 2001

Bank Insurance

> “ Emerson called this sort of thing *genius dressed in its working clothes ....* ”

What Bank Directors Must Do About Selling Insurance

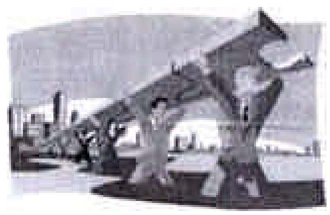
by Michael D. White

While the average return on equity (ROE) for all commercial banks dropped 127 basis points to 14.07 percent in 2000, the ROE for banks between $100 million and $1 billion in assets declined 184 basis points to an even lower 12.4 percent. And ROE at community banks with less than $100 million of assets remained flat at less than 9.1 percent.

Although noninterest income as a proportion of commercial banks' net operating revenue in 2000 was 42.8 percent, banks under $1 billion in assets lagged significantly in this department at 27.9 percent. Banks under $300 million in assets had an even lower and declining percent of noninterest income as a proportion of bank operating revenue - 21.5 percent in 2000, down from 1998. In contrast, big banks over $10 billion in assets produced more than twice as much fee income proportionally - 47.5 percent of their net operating revenue in 2000 - and virtually all of them offer annuities and insurance. Investment in new fee income strategies can produce greater community bank profitability. Lack of top-line growth or investment therein will continue alienating investors and causing price-earnings multiples to decline. Attaining new growth, strategic planning and strategic investment in new fee-revenue opportunities are more critical than ever.

Fee income activities that produce positive value for customers are essential to the survival and competitive positioning of community banks. Insurance sales offer most banks the greatest potential for increased fee revenue and profits, but each bank must carefully plot its own insurance course.

Assess Your Bank's Circumstances and Plan to Fit Them



Because there are many ways to sell insurance, some banks begin … and end … at the wrong place. They start by asking whether they should "buy, build or rent." While mode of entry into insurance is an important consideration, it is not the appropriate starting point for formulating a bank insurance strategy. Knowledge of what insurance to sell and how to sell it is best attained after a bank has evaluated its particular circumstances and ranked its opportunities.

The appropriate initial focal point for evaluating bank insurance opportunities must be the circumstances of each bank and its customer bases. Bank directors need to ask, "Who are our customers, and what business do they do with the bank? What insurance needs do they likely have? What insurance products neatly dovetail with their banking transactions, their business relationships with the bank, and their known or likely needs?"

The process of evaluating and answering these questions is what my firm calls an Economic Assessment. Assessing the economics of bank insurance sales is the essential first step to a bank insurance strategy, because it measures the answers to these questions by calculating their dollar values. To know what to do, a bank must measure its economic potential for selling insurance - by customer bases or markets, mode of market entry and means of distribution, prospect appointments and closing ratios, products and premiums, first-year and renewal commission rates, policy retention ratios and direct expenses.

The assessment should focus on traditional or mainstream protection products that most people and businesses are likely to need and buy. It should determine the sales results and fee income your bank can achieve, both by lines of insurance business, and total results, over each of the next five years. And, of course, the assessment should examine the impact of insurance sales on your bank's financial position, including its total noninterest income as a percent of net operating revenue and the contribution of net insurance income to the bank's net income.

This logical methodology forms the necessary foundation of a bank's strategic evaluation process. Emerson called this sort of thing "genius dressed in its working clothes," because it is so basic. It is basic to project a bank's realistic potential for generating insurance premiums, revenue and incremental income from its customer bases. These findings are critical to determining whether to "buy, build or rent," because once a bank determines its insurance potential, it can rationally select the insurance products to sell and the delivery systems that have the greatest potential to serve its customers and generate significant sources of fee income. Knowing this, bank directors better maximize profits and minimize risk. Only from these findings can a bank's board of directors know what the bank can and should do in terms of insurance. Directors can then rationally deduce whether, and how, their bank can most effectively enter different insurance markets: whether it should build a de novo insurance start-up, buy an agency to enter the market, or "rent" or outsource the services of an unaffiliated provider via a partnership, alliance or sales agreement.

Michael D. White, Ph.D., CLU, ChFC, is chairman and CEO of Michael White Associates, LLC. A bank insurance consulting firm, MW A is headquartered in Radnor, Pennsylvania, with offices in Georgia, and Texas. You may e-mail Dr: White at: mwa@BankInsurance.com.

A version of this article first appeared in ***ICBA Community Bank Director****,*
May/June 2001, pp. 2-3
*"**What Bank Directors Must Do About Selling Insurance**"*
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