Profits on the Horizon: Life Insurance and Annuity Sales Mean Opportunity for Illinois Banks

By

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The bank insurance battle has been raging in Illinois in the wake of the U.S. Supreme Court's decision in *Barnett*. Passage of appropriately progressive, pro-consumer legislation enabling Illinois financial institutions to sell life insurance and annuities would give Illinois banks a great opportunity to serve their customers, communities and their own bottom lines. Sufficient evidence about the Illinois life insurance market exists to support Illinois banks' position that they should be allowed to meet their customers' insurance needs.

Weaknesses in the Illinois Life Insurance Market

Demonstrable weaknesses in the Illinois life insurance market underscore the contribution to be made and opportunity to be had by the state's banks. In 1994 (the most recent year for which complete statistics are available), the state's life insurance premium receipts were down more than 4 percent from 1993, and its share of U.S. life premium receipts dropped more than 2 percent. [Author's note: life insurance market statistics are based on data published by the American Council of Life Insurance (ACLI) and the Life Insurance Market Research Association (LIMRA).] Similarly, from 1993 to 1994, purchases of ordinary life dropped over 4 percent, and Illinois' share of U.S. purchases declined 5 percent. Group life insurance in force in Illinois fell more than 12 percent, and Illinois' share of U. S. group life in force decreased 17 percent. Also, the total amount of life insurance in force in Illinois fell $8.7 billion.

For the period 1984-94, Illinois' rank among the states and District of Columbia in average amount of life insurance in force per household fell from 6th to 9th place. During this time, its share of the U.S. life insurance market declined in other categories. Its share of ordinary policies decreased almost 8 percent and stagnated in total policies in force (the latter "positive" statistic is due to the 24 percent increase in credit life policies in force which lenders like banks sell). Since 1984, Illinois' share of the U.S. market fell nearly 2 percent in ordinary face amount, 17 percent in group face amount, and 8 percent in total amount in force.

While the number of ordinary policies in force in the United States declined over 3 percent from 1984 to 1994, their number declined 11 percent in Illinois—a rate more than three times that of the nation. As total policies in force (excluding group insurance) nationally fell 12 percent, they dropped 11 percent in Illinois, but would have fallen 19 percent had Illinois lost 23 percent of its credit insurance policies like nearly two-thirds of the states instead of increasing its credit life policies in force by 563,000 (24 percent).

Again, during the period 1984-94, the number of ordinary policies in force in the United States fell by 4.98 million. Of those, 904,000 or 19 percent were Illinois policies. In 1994, the number of ordinary life policies in the United States fell by 809,000 from 1993. In Illinois they fell by 196,000, constituting nearly one-quarter (24.2 percent) of the net U.S. decline in ordinary policies that year.

By any measures, an 11 percent loss of its ordinary policies and a 19 percent share of ordinary policies lost nationally in ten years are staggering figures for a state like Illinois. During the decade 1984-94, only two states lost more ordinary life policies than Illinois, and each has a larger share of the U.S. market. Illinois lost more than the combined number of lost policies among 15 states and nearly as many as California and Texas combined.

A loss of nearly 200,000 ordinary policies and a disproportionate 24 percent share of net ordinary policies lost nationally in 1994 also signify a profound problem in the Illinois life insurance market. These declines are the result of inherent structural weaknesses of the traditional agency system (many of which I detailed in The Financial Institutions Insurance Association (FIIA) White Paper, *The Crisis in Life Insurance—How to Solve It with Freedom of Choice and Free-Market Competition*). They are not the result of weaknesses in the Illinois economy.

Since the mid-1980s, Illinois' population, number of households, personal income per capita and disposable personal income per capita have all risen, as has its ranking among the states in each category (except population). Indeed, in 1994, Illinois personal income per capita grew faster and was 9 percent higher than U.S. personal income per capita. So, Illinois is in good shape. It is the state's life insurance market that needs improvement, and Illinois banks can help provide important life insurance protection to the state's citizens.

Americans' Unfulfilled Needs for Life Insurance Protection

Much of the problem in Illinois' life insurance market—as in the rest of the country—derives from the decreasing numbers of agents, a related drop in service, and the high cost of traditional life insurance distribution that has encouraged the traditional agency system to focus on the affluent class of insurance consumers (whose policies, premiums and commissions are bigger) while neglecting other income segments.

Numerous empirical indicators evidence the failure of the traditional life insurance distribution system to adequately fulfill consumers' large, unmet needs for life insurance protection. The most significant indicator is that 40 percent of all Americans and 22 percent of all households have no life insurance coverage (see Table 1). The National Association of Life Underwriters (NALU) describes this situation as "a $5 trillion shortfall of consumers with basic life insurance needs that don't have any life insurance at all"—an amount equal to 43 percent of all life insurance in force at the end of 1994.

Some might think most of the 62 percent of all persons and 45 percent of all households that have no individual life insurance coverage are protecting themselves with group life insurance purchased at work. They would be wrong. Group life insurance has not made up the slack in decreased individual coverage. Increasing only slightly, group life insurance covers only 33 percent of all persons; and median group life coverage has increased only $1,600 since 1976.

Most people with life insurance coverage are under-insured. The median amount for all adults is just $30,000; the mean is $63,000. Thirty-seven percent have less than $25,000 in coverage. Given that many life insurance consultants recommend a rule-of-thumb average minimum of $230,000 coverage per household and that only 16 percent of adults have total coverage of $150,000 or more, it is likely that as many as 50 of the 60 percent of Americans with insurance are under-insured.

Finally, only 31 percent of consumers owning life insurance have a personal life insurance agent. Of those households with less than $25,000 in annual income (a market segment representing 40 percent of all households), only 22 percent have an insurance agent. Clearly, there is a need for life insurance, and there is an equally urgent need for banks to sell it.

The National Bank Annuity Market

Table 1. The Uninsured by Type of Insurance

	No Life Insurance	No Individual Life Insurance	No Group Life Insurance
Households	22%	45%	47%
All persons	40%	62%	67%

TABLE 2. Bank Market Share of U.S. Individual Annuity Premiums			
Year	Total Domestic Individual Annuity Receipts {a} ($ Billions)	Annuity Premiums by Banks {b} ($ Billions)	Bank Share {d} (Percent)
1990	45.02	8.0	17.8
1991	43.43	9.0	20.7
1992	45.21	12.2	27.0
1993	41.97	13.5	32.2
1994	44.42	16.39 {c}	36.9
1995	Not known yet	13.71 {c}	?
{a} ACLI	{b} Kehrer Associates	{c} Bank Insurance Market Research Group (BIMRG)	{d} Michael White Associates

Thus far, banks have applied their greatest effort and attained their greatest success selling annuities, which traditional insurance agents do not sell very much. (Annuity sales account for only 6 percent of traditional agents' first-year commissions, and only about 1 in 4 annuities are purchased from traditional life insurance agents.) Consequently, banks represent the fastest growing annuity distribution system in the country, as their market share demonstrates (see Table 2).

In 1987, consumers purchased an estimated $4 billion of individual annuities from financial institutions. By 1992, bank annuity sales had tripled. Nearly 2,200 U.S. depository institutions sold $16.4 billion in annuity premiums in 1994. From 1993-95, banks accounted for nearly $44 billion in annuity sales and an estimated $2.6 billion in gross commission or fee income. Since only 3 percent of U.S. households own individual nonqualified annuities and only 1 percent of the population own more than one annuity, future annuity sales should be considerable.

In 1994, the median bank annuity-asset-base penetration (ABP) ratio (annuity sales to assets) for all banks was 0.37 percent. Banks over $10 billion in assets had an annuity-ABP ratio of 0.28 percent, and banks with fewer than $500 million in assets achieved a ratio 10 basis points higher at 0.38 percent.

Annuity and Life Insurance Sales Potential of Illinois Banks

As of December 31, 1995, Illinois bank assets totaled approximately $238 billion. Assuming that Illinois banks may sell annuities and can improve upon their banking brethren's annuity-ABP ratio by producing at an average rate of nearly 0.56 percent (50% higher than the industry's median), they would sell approximately $1.31 billion of annuities. A 6 percent gross sales commission would produce $78.5 million in gross revenue for the state's banking industry.

According to the ACLI, in 1994 ordinary life insurance premiums in Illinois were nearly $4.6 billion. Applying national averages, $524 million are single premium life policies and $848 million are first-year ordinary life policies. I estimate roughly that 830,000 net new ordinary life policies were sold in Illinois in 1994.

Assume Illinois banks implement a retail life insurance sales program to reach some of the 4.6 million people and approximately 950,000 households in Illinois that have no life insurance. (The following scenario does not include calculation of the benefits derived from additional forms of life insurance distribution such as direct mail or telemarketing.) Presume they utilize a hub-and-spoke approach wherein, on average, one licensed agent is initially hired to sell face-to-face to customers in every four bank branches. Given the state's approximately 1,350 branches, the banking industry would initially have 338 bank insurance agents (with more to be hired as the program succeeds and expands).

Studies show that bank insurance agent productivity is 3 to 5 times greater than that of traditional insurance agents, who now average slightly fewer than 50 sales per year. If Illinois bank agents can perform at only 3 times the productivity level of traditional agents, the first group of 338 agents would make 50,700 sales per year.

With a national average annual ordinary life insurance premium of $1,020, 50,700 sales would result in $51.7 million in first-year premium. Assuming an average 80 percent first-year commission on first-year premium (which is likely to be conservative given traditional product pricing), Illinois banks would gross $41.4 million in commission revenue under this scenario.

These fairly conservative beginnings in annuity and life insurance sales could produce almost $120 million in total gross commission revenue. Assuming net income equal to 50 percent of gross revenue, once the initial phase of such a program is fully launched, Illinois banks could minimally produce $60 million in net income—with a future likely to improve significantly over the succeeding decade as the banks refine their strategy, expand their marketing programs, hone their sales skills, execute more efficiently, and improve their productivity in delivering insurance products to consumers.

For instance, it is not unreasonable to look forward to the day when Illinois banks have placed $1 billion of ordinary life premiums on the books, which would earn annual renewal commissions of approximately $50 million. At that time, renewal commissions on life insurance would equal nearly two-thirds the amount of revenue generated by annuity sales or surpass total first-year life insurance commissions produced by this sales force of retail agents initially numbering only 338.

Then, new annuity sales, new life business and life insurance renewal commissions together would minimally generate $170 million in gross commission revenue for the Illinois banking industry. Assuming experience generates further operational efficiencies such that banks could clear 60 percent of the gross revenue as net income, the industry would bank $102 million per year to its bottom line.

The scenario described is only the beginning. It does not include the revenue and income potential from reinvigorated credit life and disability insurance programs, mortgage life, business life insurance, employee benefits, personal lines, auto warranty, commercial property and casualty lines, and other insurance-selling opportunities for Illinois banks.

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