THE LEGALITY OF BANCASSURANCE AND THE NEED FOR REFORM

Lyssa Maria Brito, Bhat & Rao, Advocates

ABSTRACT

In this article, the legality of Bancassurance arrangements is analysed. 'Insurance' has been declared by the Government to be is a permissible form of business that could be undertaken by banks under Section 6(1) (o) of the Banking Regulation Act, 1949. On a first glance, it would appear that Bancassurance is a cost-effective measure to promote the penetration of insurance in India which benefits the customers, the insurance companies and the banks and which ultimately promotes economic development. However, there are several legal issues that are involved in the cooperation between banks and insurance companies.

The first issue that is looked at in this paper is whether Bancassurance infringes the rights of banks clients or customers. Customers may be misled by banks into buying insurance products of the insurance company of which the bank is an agent or a partner. Bancassurance may limit the choice of customers to choose an insurer. The sharing of customer information with insurance companies by banks is another legal issue that arises. Furthermore customers of insurance products through banks may and often do face problems in the settlement of claims of insurance. The current group structure makes it difficult and in some cases impossible for the insured or their heirs to bring their claims directly to the insurer.

Secondly in this paper the issue of whether Bancassurance is anti-competitive is examined. It could be argued that there exists a coercive arrangement between banks and the clients financed by the banks in insurance retailing by banks which is in contravention of the Competition Act being an exclusive supply arrangement. The exclusive distribution agreement between various insurance companies and their agent banks restricts the independent agents and insurance brokers from selling insurance products to customers of banks. Furthermore, banks, because of their size, resources, economic power and market share, are dominant market players and are abusing their dominant position in contravention of the provisions of the Competition Act by indulging predatory pricing, restricting the insurance retailing market for other independent insurance agents, denying market access to independent insurance agents and using their dominant

position in banking market to charge overly high commissions from insurance companies.

Finally in this paper the existing legal framework to regulate Bancassurance in India is looked at to determine whether there exists any lacuna in the law and whether there is a need to introduce amendments or reforms.

INTRODUCTION

Broadly bancassurance refers to a model of distribution of insurance products through specific banking companies.[1] In India, bancassurance can take various forms. An insurance company may be set up as a subsidiary of a bank or a bank may enter into a joint venture agreement with an insurance company or alternatively banks or their subsidiaries may be appointed as agents or brokers of the insurer.[2] Bancassurance was introduced in India through a government notification in 2000 declaring insurance as a permissible form of business for a banking company under Section 6(1)(o) of the Banking Regulation Act.[3] Thus in instances of bancassurance which involve the convergence of banking and insurance business, there are two primary sectoral regulators, namely the Reserve Bank of India and the Insurance Regulatory and Development Authority of India.

There are two primary groups of stakeholders that are affected in instances of Bancassurance arrangements, namely:

1. The competitors in the insurance and banking sectors
2. The customers of the banks and the policy holders

One of the primary policy aims of the Government is to increase the insurance penetration in the country.[4] Therefore in this paper, the legal consequences of Bancassurance arrangements with respect to these groups of stakeholders are analysed in the light of existing laws for the purpose of determining which changes, if any, are required to be made in the legal framework for the same.

[1] Report of the Committee of Bancassurance, Insurance Regulatory and Development Authority 12 (26th May 2011).
[2] Master Circular – Para Banking Activities, DBR.No.FSD.BC.19/24.01.001/2015-16, Reserve Bank of India (July 1st 2015).
[3] Circular MPD.No.BC. 196/07.01.279/99-2000, Government of India (27th April 2000).
[4] § 3(c)(1), Insurance Regulatory and Development Authority of India (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations, 2016.

BANCASSURANCE AGREEMENTS AND ANTI-COMPETITIVENESS

Anti-Competitive Agreements

Anti- Competitive Agreements are prohibited under Section 3 of the Competition Act, 2002. Banks act as agents of the insurer in the distribution and sale of insurance products and thus, both the bank and the insurer operate at different stages of the production chain. The agreement between the bank and the insurer is in respect of the provision of services of agency or brokerage provided by the bank. Therefore Bancassurance agreements are subject to challenge on the ground on anti-competitiveness provided that they have an appreciable adverse effect on competition (*hereinafter referred to* "AAEC").[5] In this context Bancassurance arrangements could lead to anti-competitive consequences in several ways:

1. **A Tie-In Arrangement**

   Where the bank requires its customer as a condition of purchasing its banking services to purchase an insurance product, the same would be an anti-competitive agreement provided that it has an AAEC.[6] The requirement of having an AAEC is satisfied when the seller has such a degree of market power that it can force the buyer to purchase the tied product.[7] Since people are usually dependent on banks and once a customer opens an account with a bank it is difficult to switch to another bank, it is reasonable to assume that banks do possess the requisite power to force the buyer to purchase the ancillary insurance product. However the danger of such tie-in arrangements has been addressed in the Insurance Regulatory and Development Authority of India (Registration of Corporate Agents) Regulations, 2015 where it has been provided that where the insurance is sold as an ancillary product along with a principal business product, the corporate agent shall not compel the buyer of the principal business product to necessarily buy the insurance product through it.[8] However although this legal prohibition for compulsory tie-in arrangements has been laid down, the situation is more complex because banks are not just normal vendors of services but rather they

[5] § 3(4), Competition Act, 2002.
[6] § 3(4) Explanation (a), Competition Act, 2002.
[7] *Shri Sonam Sharma v. Apple Inc. USA & Ors*, Case No. 24/2011(19.03.2013 - C.C.I).
[8] § 21(ii), Insurance Regulatory and Development Authority of India (Registration of Corporate Agents) Regulations, 2015.

occupy a position of being a *"trusted advisor"*[9] thus making it feasible that indirect coercion through advice may defeat this provision of the law.

2. Exclusive Distribution Agreement

When the agreement between the Bank and insurer limits, restricts or withholds the supply of any insurance products by making the bank the exclusive agent or broker of the insurer, such an agreement would be anti-competitive.[10] Such agreements limit or restrict the independent insurance agents and brokers from selling insurance products especially to customers of banks. Exclusive arrangements of dealership or distribution are anti-competitive provided that they have an AAEC and this is decided with reference to the factors provided in Section 19(3) of the Competition Act, 2002.[11] In order to address this, the Insurance Regulatory and Development Authority of India has prohibited any corporate agent from promising to distribute the products of a particular insurer and further no insurer shall compel the corporate agent to distribute the products of a particular insurer.[12]

Under the Insurance Regulatory and Development Authority of India (Registration of Corporate Agents) Regulations,2002, a corporate agent could sell policies of only one life insurer or one general insurer or both as the case may be.[13] However this restriction was removed with the notification of the Insurance Regulatory and Development Authority of India (Registration of Corporate Agents) Regulations,2015, as per which a corporate agent may have arrangements with a maximum of three life insurers or general insurers or health insurers or all of them as the case may be to solicit, procure and service their insurance products.[14] It should be noted that the change introduced does not compel the banks to have arrangements with at least three different insurers for each category, but only gives the banks the freedom to have arrangements with a maximum of three insurers in each category. Therefore it is still open to the banks to have arrangements with only one insurer. This could potentially lead to anti-

[9] *See,* Nicholas T. Miller and Glen Staada, *The Trusted Advisor in the Small Business and Middle-Market Banking*, 25 Com. Lending Rev. 3 (2010).
[10] § 3(4) Explanation (c), Competition Act, 2002.
[11] *Mr. Mohit Manglani v. M/s Flipkart Pvt. Ltd & Ors*., Case No. 80/2014 (24.04.2015 – C.C.I).
[12] §§ 23(b), Insurance Regulatory and Development Authority of India (Registration of Corporate Agents) Regulations, 2015.
[13] Insurance Regulatory and Development Authority of India (Registration of Corporate Agents) Regulations,2002, § 3(2) second proviso.
[14] Insurance Regulatory and Development Authority of India (Registration of Corporate Agents) Regulations,2015, § 3.

competitive consequences since in many cases banks agree to serve as the agent for only one insurer (which is usually a subsidiary of the bank) and this prevents other insurers who do not have any promoter bank from selling insurance products through this channel.[15]

3. Refusal to Deal

When the Bancassurance agreement restricts, or is likely to restrict, by any method the persons or classes of persons to whom insurance are sold or from whom goods are bought, then the same would be an anti-competitive agreement provided that there is AAEC.[16] It is pertinent to note that even if the agreement is *likely* to restrict the persons to whom the insurance products are sold or from whom they are bought, then the same is covered under this. When a bank is appointed as the sole agent of the insurance company, then this restricts or limits the classes of people to whom insurance products are sold since many banks follow a policy of only dealing with their customers.

Bancassurance and Abuse of Dominant Position

Section 4 of the Competition Act, 2002 deals with abuse of dominant position by an enterprise. According to this section, dominant position means a position of strength, of an enterprise, in the relevant market, which enables it to operate independently of competitive forces prevailing in the relevant market or to affect its competitors or consumers or the relevant market in its favour.[17] In order to establish that the bank or the insurance company are through a Bancassurance agreement are contravening the provisions of section 4, it must first be shown that they enjoy a dominant position in the market. Generally in both sectors it is extremely difficult to prove that any single banking or insurance company enjoys a dominant position because of the highly competitive nature of these markets.[18] However in Bancassurance arrangements, it is highly possible that the partnership between a banking company and an insurance company together will give rise to a dominant position in the two markets combined due to benefits of economies of scale, larger customer base, greater access to market data and

[15] *See* M Saraswathy, *Agents May Enter Into New Tie-Ups in FY17 with IRDAI Nudge*, Business Standard (2016), https://www.business-standard.com/article/finance/corporate-agents-may-enter-into-new-tie-ups-in-fy17-with-irdai-nudge-116021800705_1.html.
[16] § 3(4) Explanation (d), Competition Act, 2002.
[17] § 4(2) Explanation (a), Competition Act, 2002.
[18] *See In re Vikas Kumar Goel v. Standard Chartered Bank*, (2015) CCI 14, (23.06.2015 – C.C.I.); *In re Association of Third Party Adminidtrators & Ors*., Case No. 107/2013 (04.01.2016 – C.C.I).

so on.[19] The bank and the insurance partner may abuse this dominant position by indulging in activities by denying access to independent insurance agents or by fixing anti-competitive or predatory pricing policies to eliminate other competition in the insurance market. The same was argued in the case of *Shri Dilip Modwil v. Insurance Regulatory and Development Authority of India*[20] however the Competition Commission dismissed the case for lack of jurisdiction.

BANCASSURANCE AND RIGHTS OF CUSTOMERS

Under a scheme of Bancassurance, a bank sells the products of the insurer to its own customers and the bank acts as the intermediary between the customer and the insurer. This is convenient for both the insurer and the customer since the customer is relieved of the burden of transacting directly with the insurer or with another agent and the insurer benefits from the infrastructural facilities of the bank and acquires access to a wide customer base. However, despite these obvious benefits there are several legal issues in such an arrangement that may result in impairing the rights of customers of the bank.

1. Conflict of Interest

The primary relationship between a banker and a customer is that of a debtor and a creditor which arises by virtue of the customer's deposits.[21] However in cases where the bank acts as an advisor to its customer, the bank owes a fiduciary duty to his customer to act in his best interests.[22] Therefore when a bank advises a customer to take up an insurance policy, the bank owes a fiduciary duty to the customer to give advice which is in the best interest of the customer. In in such a case, this would relate to advising the customer to take up insurance policies with the widest risk coverage and the lowest premiums payable.

In a bancassurance arrangement, the bank is either the agent of the insurer or an insurance broker. Therefore a conflict of interest vis-à-vis the customer since the bank as an insurance intermediary is paid a commission by the insurer in question, and this commission is expressed as a percentage of the premium that is paid by the policy

[19] Serap O. Gonulal et. al., *Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets*, Policy Research Working Paper 6196, The World Bank (September 2012).
[20] *Shri Dilip Modwil v. Insurance Regulatory and Development Authority of India*, Case No. 39/2014 (12.09.2014 – C.C.I).
[21] *Velji Lakhansey and Company v. Dr. Banaji*, (1955) 25 Comp Cas 395.
[22] *Woods v. Martins Bank Ltd.*, [1958] 3 All ER 166.

holders.[23] The bank will earn a higher premium if the customer opts for a policy on which a high rate of premium is payable. Therefore this situation could lead to consequences which are detrimental to the interests of the customer. This situation is addressed in the Insurance Regulatory and Development Authority (Licensing Of Corporate Agents) Regulations, 2002 where under section 21(1) where a duty is cast on the bank to intimate to a prospective customer the list of all the insurers having tie-ups with the bank and to provide all relevant information about all the insurance products available.

2. Confidentiality of Customer Information

There are concerns that Bancassurance could lead to data sharing between the bank and the insurer. Thereby this could lead to the divulging of personal information of the customer of the bank to the insurer without the customer's consent. Such sharing of data would violate the customer's right to confidentiality and would constitute a breach of the duty of secrecy of the bank.[24] Alternatively, the customer who wishes to procure an insurance policy may be constrained to divulge certain information to the bank as the insurance intermediary which the customer might wish to avoid.

CONCLUSION

In order to prevent the occurrence of anti-competitive arrangements between a particular insurer and a bank, proactive measures should be taken in order to prevent any such arrangements from being entered into. In order to tackle anti-competitive arrangements which are in the nature of a Refusal to Deal or an Exclusive Distribution Agreement, it should be made mandatory for banks to enter into Bancassurance arrangements with a minimum number of insurers which should be more than one.

Further in order to ensure that multiple insurance partners of banks are treated at equitably, a cap should be imposed on the maximum amount of premium that a bank can collect on behalf on a single insurer. This maximum limit should be expressed as a percentage of the total amount of insurance premium collected by the bank. Further since anti-competitive Bancassurance

[23] K. Murali, *Evolution of an Insurance Intermediary- A Specie Called Brokers,* IRDA Journal, Vol. XII , No. 4, 16 (April 2014).
[24] *Shankarlal Agarwalla v. State Bank of India,* A.I.R. 1987 Cal. 29.

agreements would be most likely to be entered into between a bank and its subsidiary insurance company or group company, specific approvals and disclosures must be mandated in such cases.

With respect to protecting the rights of customers in Bancassurance arrangements, it is essential to remove the conflict of interest of the banks. This can be done by keeping the amount payable as commission to the bank constant and independent of the amount of premium collected from the policy holders. Therefore, if the commission payable to the bank does not depend on the choices of the customers with respect to different insurance policies, the conflict of interest will be removed.

The issue with respect to the issue of maintaining the confidentiality of customer information, there is a large lacuna in the law. It is essential that a data protection law is enacted to adequately safeguard the interest of the customer in this regard.

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