

IS BANCASSURANCE A VIABLE MODEL FOR FINANCIAL FIRMS?

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ABSTRACT

The bancassurance (i.e., bank and insurance company combinations) model for financial firm architecture has been widely used in Europe and recently has been adopted by U.S. financial firms. We provide evidence regarding the viability of bancassurance combinations for U.S. and non-U.S. mergers between 1997 and 2002. We find positive gains and no significant risk shifts for shareholders of bidding firms, and that higher CEO stock ownership results in less positive gains for shareholders. These and other results suggest that bancassurance firms are viable entities that may play an important role in the future evolution of the U.S. financial system.

INTRODUCTION

Although mergers between banks and insurance companies, known as bancassurance mergers, have been frequent in Europe for many years, they have not been a part of the U.S. banking system because of prior legislative restrictions. Passage of the Financial Modernization Act (also known as the Gramm–Leach–Bliley Act) in 1999 fundamentally altered the expansion opportunities for commercial banks and insurance companies. For the first time since 1933 when the Glass–Steagall Act was adopted, these financial firms could acquire one another and operate under one corporate umbrella by forming Financial Holding Companies, variously referred to as universal banks, financial supermarkets, and financial conglomerates.¹ Indeed, since passage of this legislation, a large number of commercial banks and insurance companies have taken advantage of the reduced restrictions on their expansion into these and other financial service areas, both through acquisitions and through *de novo* means.

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¹ The Act also allows for the acquisition by insurance companies or banks of investment banks and for investment banks to acquire banks and insurance companies.

Deregulation that allows for diversification across both financial services as well as geographic areas (under the Interstate Banking and Branching Efficiency Act of 1994) together provide a potent rationale for the growth of banking and insurance combinations in the years ahead. As a result, mergers between commercial banks and insurance companies have the potential to fundamentally change the U.S. financial landscape. However, that potential will become reality only if the bancassurance model is, in fact, a viable one. Unfortunately, there currently exists little direct empirical evidence on the value and risk implications of this form of business combination.

We provide evidence in this article on the following questions: (1) Do bancassurance merger announcements increase the stock prices of bidding firms? If so, what financial, corporate governance, and other factors explain the higher stock prices among bidders? (2) Do bancassurance mergers alter the risk profile of the merged firm? To date few studies examine the bancassurance phenomenon, and those that do typically use simulated data or have extremely small sample sizes. Ours is the first study to examine this important issue using actual data from bancassurance mergers and to do so with a large sample of both U.S. and non-U.S. mergers.

We attempt to answer these questions by examining a relatively large sample of 129 bank–insurance mergers among U.S. and non-U.S. companies in the period 1997 through 2002. We find that bancassurance mergers do provide small positive wealth effects for bidders whether they are insurance companies or banks. In addition, transactions that result in geographic diversification for the combined firm result in positive announcement responses, as do transactions in which the bidder has a high return on assets. We also find that bidder returns in bancassurance mergers are associated with their governance characteristics. For example, mergers in which the bidder’s CEO has a large fraction of his firm’s stock are less well received. This suggests the possible existence of CEO entrenchment that allows for non-value-enhancing behavior on the part of the bidder. We do not, however, find that bank–insurance combinations alter the risk profile of acquiring firms. Our results imply that the bidder gains are principally driven by increases in the operating cash flows anticipated from the merger rather than from risk reductions.

In “Background Discussion,” we provide a discussion of the previous literature. In “Sample Characteristics and Empirical Methods,” we provide an overview of the sample selection procedure, sample characteristics, and the empirical methods employed. In “Empirical Results,” we report and discuss our event study findings and our cross-sectional analyses of bidder abnormal returns. In “Conclusion and Implications” we conclude the article.

BACKGROUND DISCUSSION

The Evolution of Bancassurance

Many authors have observed that banks and insurance companies as businesses provide services that have more similarities than differences, which favors their joint production. Both types of firms are financial intermediaries that pool savings of individuals and subsequently channel these funds to capital expenditures. Laws of large numbers, economies of scale, liquidity creation, and risk management are common to both institutions (Lewis, 1990; Levy-Lang, 1990; Voutilainen, 2004). It is not surprising that they offer similar products to compete for public savings funds. For

example, homeowners typically use endowment policies to repay principal in the United Kingdom. In France, insurance companies have sold single-premium policies that are similar to bank time deposits. Also, banks regularly offer loans and sell insurance to protect against default and property loss. Historically, bancassurance was most developed in France and the Netherlands in the 1980s, due in part to tax-advantaged insurance products made available through banks, in addition to the distribution network and public confidence advantages for banks (Hoschka, 1994; Genetay and Molyneux, 1998; Staikouras and Nurullah, 2005).

In Europe during the 1990s, significant entry by banking firms into insurance activities was primarily motivated by deregulation of the financial sector under the 1989 Second Banking Coordination Directive. Effective in January 1993, this Directive allowed financial institutions in European Union (EU) countries to operate in member countries without obtaining a license from the regulatory authorities in a guest country. EU competition among so-called universal banks and large retailers entering financial services has led to cross selling of multiple services. Banks increasingly have used relationship pricing whereby customers purchasing a number of financial services receive better pricing than single-product customers. Consequently, bancassurance has been growing more rapidly in Europe than banking–securities combinations.

One explanation for the success of bancassurance is that bank–insurance combinations are beneficial to both entities in terms of spanning both short- and long-term liability/asset structures in the financial intermediation process and better attracting and retaining retail customers and corporate clients (Diamond, 1984). In the past, as observed by Carey et al. (1993), a credit market hierarchy existed among private debt (inside bank loans), private placements (inside insurance company bonds), and the public debt market (outside debt). Legal barriers affecting the sources of funds among different financial institutions logically led to asset specialization of institutions (e.g., long-term vs. short-term lending) on the supply side of the credit market. For example, owing to the traditional legal separation of banking and insurance underwriting, the majority of bank credit is financed by short-term, floating-rate deposits, whereas life insurance companies obtain funds to invest in bonds from long-term, fixed-rate insurance contracts. Importantly, deregulation eliminated these legal barriers and allowed banks and insurance companies to exploit their joint advantages with respect to both short- and long-term funds in the financial marketplace.

Risk Reduction and Value Enhancement Effects of Bancassurance

Few studies have examined the effects of the diversification achieved by banking and insurance company mergers per se. As discussed by Boyd, Graham, and Hewitt (1993), numerous studies have attempted to determine the potential effects of expansion of bank holding companies into permissible nonbank activities and prohibited nonbank activities. However, these studies investigate different financial services firms separate from one another, rather than merger combinations of banks and nonbank firms.

Rumelt (1974) argues that diversification is more likely to be value enhancing when management skills and physical resources across firm segments can be applied in related markets. Consistent with this view, Rajan, Servaes, and Zingales (2000) propose that diverse divisions within a firm can lead to inefficient allocation of resources and investment and lower firm values. Also, Berger and Ofek (1995) find that diversified

TABLE 1

Literature Summary Regarding Risk Changes Resulting From Mergers Involving Banks and Insurance Companies

Study	N	Years	Risk Measure	Risk Impact
Boyd and Graham (1988)	30	1971–1984	ROE volatility	Reduced
			Probability of failure	Reduced
Boyd, Graham, and Hewitt (1993)	30	1971–1987	Probability of failure	Reduced
Saunders and Walter (1994)	21	1984–1988	Stock return volatility	Reduced
Genetay and Molyneux (1998)	41	1988–1992	ROA volatility	No change
			Probability of failure	Reduced
Estrella (2001)	10	1989–1998	Probability of failure	Reduced

firms have values that are 13–15 percent below the sum of the imputed values of their segments, but this loss is mitigated in cases of more focused diversification within related industries. Diversification can enhance value through increased cash flow and/or through reduced risk.² Therefore, merger studies assess the impact of mergers on stock returns of the bidder (which could imply improved future cash flows or anticipated risk reduction or both) or on the risk changes experienced by the bidding firm. The focus of the few studies that do examine bancassurance (unlike in the corporate finance literature) is principally on changes in risk. An exception is Fields, Fraser, and Kolari (2007), who find that bidders in bancassurance mergers experience positive wealth effects and that these wealth effects appear to be driven by enhanced economies of scale and scope and by geographic diversification.

The focus on risk in most prior studies seems to derive from regulatory concern about potential failures that might result from bancassurance mergers and the possibility of the transmission of that risk to the entire financial system. Not only do we examine the impact on the risk of the acquiring firm in bancassurance mergers, we also provide evidence on the effects of these merger announcements on the value of the acquiring firm. The evidence that we provide on the valuation effects of bancassurance mergers adds substantially to an area of research that has been previously neglected in the literature.

Most bancassurance studies conduct simulated mergers and generally find that bancassurance mergers tend to lower earnings volatility, stock return variance, and failure risk. Table 1 provides a summary of the key findings of these studies (see also Brewer, Fortier, and Pavel, 1988; Wall, Reichert, and Mohanty, 1993). A clear inference from these studies is that there appears to be risk reduction associated with banking–insurance combinations.

² Empirical tests in the corporate literature (e.g., Lewellen, 1971; Stulz, 1990; Comment and Jarrell, 1994) are mixed concerning diversification, with both potential benefits (e.g., increased efficiency of resource allocation, lower underinvestment problems, greater debt capacity, and debt tax shields), and costs (e.g., overinvestment in poor investment opportunities, cross-subsidization of failing business segments, and information asymmetry costs between managers in decentralized firms).

Although there are obvious drawbacks associated with examining simulated rather than actual bancassurance mergers, the main reason for simulating bank–nonbank financial firm mergers has been that actual merger sample sizes have been insufficient for estimation purposes. For example, Cybo-Ottone and Murgia (2000) examined the shareholder wealth effects of 54 large European bank mergers (exceeding \$100 million) but found only 10 banking–insurance mergers with publicly traded stock price data for both buyer and seller and, of these, only 8 were completed. Consistent with most merger studies, targets experienced wealth gains, whereas acquirers had no significant changes in their share prices around merger announcement dates in the period 1988 through 1997. These small sample sizes make it difficult to draw meaningful inferences about the wealth effects of bancassurance or the potential sources of gains. In the present study, we substantially increase the sample size of bank–insurance mergers in an effort to better understand both their wealth and risk effects.

Governance Issues in Bancassurance

Prior research into mergers among commercial banks suggests that the market response to these announcements is also influenced by the governance characteristics of the bidder. As a result, and unlike other bancassurance studies, we explicitly considered the influence of a number of governance factors under the expectations that firms with “good” corporate governance should make investment decisions (including acquisitions) that are better than their less well-governed peers.³ For this study, we focus on three governance characteristics that may be important: ownership structure, board composition, and executive compensation.

With respect to ownership structure, Jensen and Meckling (1976) state that firm value increases as managerial stockholdings increase because managers who own shares of their firms’ stocks are more likely to have their interests aligned with those of outside shareholders. Stulz (1988) shows that the relation between firm value and managerial ownership is not monotonically increasing over the entire range of managerial ownership. Rather, firm value increases as managerial ownership increases (owing to better alignment of incentives with outside shareholders) but only to a point. At some point, managerial entrenchment results in making the probability of takeover very low because a bidder would be required to pay an excessive premium in order to acquire the firm. Therefore, we would find positive bidder returns for low levels of managerial ownership. However, at ownership levels that imply insider entrenchment we expect negative or at least less positive bidder returns. There is no “fixed” level of inside ownership that implies managerial entrenchment, but for very large firms the percentage could be relatively small. In addition, large (5 percent or greater beneficial) block ownership influence firm decision making. Blockholding tied to firm management (or affiliated blockholdings), such as those held in trust for employee retirement

³ There are at least two sources of the observed variation in governance mechanisms: (1) governance characteristics that differ across firms owing to differences in firm circumstances (e.g., strategy and/or regulation) and (2) governance characteristics that differ due to deviations from the optimal governance mix for the firm owing to agency problems. By focusing our study on the financial services industry we hope to eliminate many of the factors associated with the firms’ regulatory environments etc. so that we are able to interpret the observed variations as deviations from optimal governance.

but voted by management, have the same positive and negative effects for the firm as all other managerial holdings. Of course for the impact on the firm of managerial holdings and affiliated blockholdings voted by management to be identical, managers would have to vote the affiliated blocks in ways that were completely self-interested. On the other hand, unaffiliated blockholders have both the incentives and the ability to monitor managerial actions (Fama and Jensen, 1983). This monitoring contributes to less managerial misbehavior and to better decision making. Therefore, we expect better acquisitions to be made by bidders of firms with one or more large unaffiliated blockholders.

Regarding board composition, evidence on the value of firms having an independent board of directors is mixed. The NYSE and other exchanges now have guidelines in place recommending that listed firms have independent boards of directors. However, even if board composition is effective as a monitoring device for the typical industrial firm, there are reasons to believe that such effectiveness is limited for financial firms. Subrahmanyam, Rangan, and Rosenstein (1997) state that outside directors for banks may be appointed for their business expertise rather than their ability to assess the value of potential targets. Moreover, they note that the added responsibility placed on bank outside directors to represent the interests of the FDIC and others as well as the firm's shareholders limit the number of viable candidates for the board. Contrary to findings in the corporate finance literature, they find a negative relation between bidder abnormal returns and board independence. Hence, it is unclear whether bancassurance mergers will be more favorably viewed by bidder shareholders if the bidder has an independent board. In addition, Yermack (1996) finds that smaller boards of directors are associated with higher measures of Tobin's Q. Consistent with Yermack, Subrahmanyam, Rangan, and Rosenstein find that smaller boards are positively related to bidder abnormal returns. Banks tend to have large boards of directors relative to industrial firms. Therefore, board size may increase as a result of bancassurance mergers resulting in less positive bidder abnormal returns.

Finally, executive compensation packages can be designed so that managerial and shareholder interests become more aligned. Stock- or incentive-based compensation for the CEO and other managers has the potential to make managers less risk averse and to entice them to make acquisitions that are advantageous to outside shareholders. However, recent evidence by Erickson, Hanlon, and Maydew (2004) shows that incentive compensation, though providing alignment of incentives between CEOs and shareholders at low levels, increases agency problems if the high levels of stock-based compensation induce managers to commit accounting fraud. Therefore, the relation between incentive-based compensation and bidder abnormal returns is unclear for the financial firms in our sample.

SAMPLE CHARACTERISTICS AND EMPIRICAL METHODS

Data Selection and Sample Characteristics

We use Securities Data Company (SDC) data to identify the initial sample of all mergers and acquisitions (hereafter *mergers*) between banks and insurance companies that took place between January 1997 and December 2002.⁴ To be included in the final

⁴ Banks and insurance companies are identified using Standard Industry Classification (SIC) codes.

sample, the merger must meet the following criteria: (1) the bidder is a publicly traded firm with data available on Datastream or CRSP, (2) the bidder does not own a controlling interest in the target prior to the merger announcement, (3) the merger results in the bidder owning a controlling interest in the target, and (4) the merger is completed as confirmed by either SDC or press releases. Data were gathered from BancScope for bank bidders and from ISIS for insurance company bidders and targets and from Global Vantage (Compustat).⁵ The final sample of 129 events consists of 105 bank bids for insurance companies and 24 insurance company bids for banks. The majority of the mergers are between public bidders and private targets. The sample is fairly evenly distributed across time after 1998.

Although the sample is composed of U.S. and non-U.S. bidders and targets, the distribution of these events is not evenly spread across subsamples. For example, almost all of the acquisitions involving public bidders and private targets involve a U.S. bidder, a U.S. target, or both. On the other hand, of the events in which both bidders and targets are publicly traded companies, only a small number of the mergers involve a U.S. bidder or a U.S. target. The most common non-U.S. country of origin for bidders with public targets is Spain, whereas the most common non-U.S. targets were from Switzerland. These facts are not surprising given the historical evolution of the bancassurance model. Non-U.S. bancassurance mergers historically have tended to involve mergers between two large and generally publicly traded financial firms. U.S. bancassurance mergers have to this point involved mostly large publicly traded financial firms acquiring nonpublic targets.

Table 2 shows many of the variables that were gathered for our analysis. These variables include transaction as well as bidder characteristics, and bidder governance data. Most (71 percent) of the transactions in which an insurance company was the bidder involved a public target, whereas less than one third (28 percent) of the transactions in which a bank was the bidder involved a public target. Payment was made with stock in most of the transactions, involving both commercial banks and insurance companies. The majority of the transactions were friendly (deals where both target and bidder management cooperate), as is typically the case in mergers between financial firms. U.S. bidders generally involved banks acquiring insurance companies, whereas non-U.S. bidders generally involved insurance companies acquiring banks. Relatedly, cross-border acquisitions were more common for transactions in which the bidder was an insurance company. The target return on assets was much higher if the target was an insurance company, and the total assets of the insurance companies were generally greater than the total assets of the banks involved in these bancassurance mergers.

The governance variables provided in Table 2 are available from proxy statements only for U.S. publicly traded bidders. Given that the vast majority of insurance bidders are non-U.S. firms, and only three U.S. insurance bidders with governance data are available, it is difficult to draw conclusions regarding governance for the insurance bidders. Therefore, we report and discuss only bidder governance for banks buying insurance companies. Mean and median board size is approximately 14 members. Commercial bank boards are generally larger than boards of nonfinancial firms. These boards are

⁵ BancScope and ISIS are databases produced by Bureau Van Dyke.

TABLE 2

Descriptive Characteristics for Mergers Involving Banks and Insurance Companies Announced Between 1997 and 2002

Variable	Bank Mean	Bank Median	Insurance Mean	Insurance Median
Deal and firm variables				
Deals with public targets	27.52%	n.a.	70.83%	n.a.
Stock deals	79.81%	n.a.	58.33%	n.a.
Friendly deals	98.17%	n.a.	91.67%	n.a.
U.S. bidder	65.14%	n.a.	12.50%	n.a.
U.S. target	8.33%	n.a.	66.97%	n.a.
Bidder and target, same country	83.48%	n.a.	58.33%	n.a.
Bidder return on total assets	0.92%	1.021%	1.08%	0.910%
Target return on total assets	0.71%	0.547%	1.62%	1.158%
Bidder market value of equity (\$000s)	9,081.67	1,556.29	30,172.58	27,787.94
Governance variables^a				
Number of directors (board size)	13.91	14.00		
Number of outside directors	9.12	9.00		
Number of inside directors	2.89	2.00		
Number of gray directors	1.91	2.00		
Board with target industry experience	31.82%	n.a.		
Affiliated block ownership	4.76%	0.00%		
Unaffiliated block ownership	3.13%	0.00%		
CEO ownership	2.05%	0.95%		
Officer and director (not CEO) ownership	9.67%	6.46%		
CEO total (nonoption) compensation	1,087,533	790,911		
Percentage of CEOs with options	75.75%	n.a.		
Percentage of CEOs w/restricted stock	30.30%	n.a.		

Notes: Deal characteristic data are extracted from Security Data Corporation (SDC) Mergers and Acquisitions database. Deals are classified as public if the target of the firm being purchased is a publicly traded corporation. Deals are classified as stock deals if they include stock as a portion or all of the payment for the target. Friendly deals are negotiated between bidder and target management (as opposed to hostile deals, which do not require the cooperation of target management). Bidder governance data are gathered from proxy statement. Inside directors are directors with direct ties to the firm such as managers of the firm. Gray directors are directors with business or other associations with the firm that might result in the directors' being impartial (such as lawyers or accountants). Outside directors are board members with no direct or indirect ties to the firm. Boards with target industry experience is a measure of how many of the firms in our sample have members who have worked in the same industry as the acquisition target

^aThere are only three insurance bidders with available governance data; therefore, we do not report the means and medians as they are of limited value.

largely independent, with an average of about three inside directors. Directors are classified as insiders if they have direct ties to the firm (e.g., managers, former employees of the firm, and relatives of management). Of the 11 outside board members, on average we classify 2 as gray and 9 as independent. Directors are classified as gray directors if they have business ties to the firm that may induce them to side with

management, thereby rendering them less objective than true outsiders who have no direct or indirect ties to the firm. For example, they may vote with management on proposals that tend to favor management over shareholders, such as antitakeover proposals. In over 30 percent of the cases, the banks have one or two board members with a history of working in the insurance industry. We report 5 percent or greater beneficial stock ownership considered to be affiliated with the firm (mostly stock held in employee plans) and also block ownership considered to be independent or unaffiliated with the firm. Although many firms have large (5 percent or greater) block ownership, the median affiliated and unaffiliated blocks held are zero. This finding is not surprising given the large size of most of these banks.

Table 2 also shows the amount of insider ownership for both the CEO of the firm and for the officers and directors of the firm as a group (excluding the CEO). We find that median CEO beneficial stock ownership approaches 1 percent. Although this percentage may seem small, even a small ownership stake could imply a degree of managerial entrenchment for these large banks. Relatedly, the mean of bank CEO ownership is 2 percent, suggesting that some CEOs have very large positions in their organizations. The other officers and directors of the banks own close to 10 percent (mean) of the banks' shares.

The mean nonoption compensation of the CEO was a little over \$1 million for the bank bidders in our sample. In addition, over 75 percent of the top managers receive compensation in the form of options, and over 30 percent receive restricted stock. Clearly, the majority of CEOs of our banks are compensated with incentive-based pay. Also the level of nonincentive-based compensation is relatively high, again reflecting the size of the banks involved in our study.

Empirical Methods

Event Study Analysis. We use event study methods to determine whether announcements of mergers between insurance companies and banks impact bidder shareholder wealth. Announcement dates are based on bidder home country dates. For example, if a Japanese insurance company acquires a U.S. bank, the announcement date would be the date in Japan. Malatesta (1983) shows that measurements of the wealth effects of mergers are highly sensitive to model specification. Therefore, we use numerous approaches to calculate abnormal returns, including the market model, the mean adjusted returns model, and a comparison period approach. The estimation period is 200 days ending 51 days prior to the announcement.⁶ We use two approaches with market model estimation. First, we utilize a world index for all bidders in the sample. Second, we utilize a country-specific market index for each bidder.

⁶ We use an estimation period that balances the trade-off between reasonable length (to provide sufficient time to identify "typical" returns patterns) and sample size. Previous research has shown that information regarding mergers typically begins to leak in the month or two prior to the announcement. We begin our estimation period 2 trading months (50 days) prior to the announcement to avoid any run-up in price that may be experienced due to information leakage. However, we did try other estimation periods that were shorter and were closer to the announcement period (no more than 1 month prior), and we find that the results are robust to selecting different estimation periods.

An alternative approach is to take a longer term perspective and to measure the long-run financial performance (either based on stock prices or financial accounting data). However, measuring financial performance over an extended period is complicated by the confounding effects of changes in economic and financial conditions and in regulatory regimes, all of which may produce biases in the results. Therefore, we confine ourselves to examining the market's immediate response to the merger announcement that contains at that time the market's best estimate regarding the merger's prospects.

Multivariate Analysis. Our first set of models is developed using variables chosen primarily due to precedent in the general merger literature (Bruner, 2005) and in the banking literature (e.g., Hannan and Rhoades, 1987; Cheng, Gup, and Wall, 1989; Vander Venet, 1996; Houston and Ryngaert, 1994; Thompson, 1997; Focarelli, Panetta, and Salle, 2002). We relate bidder announcement abnormal returns to bidder and transaction characteristics. We include in these models bidder size (total assets), bidder profitability (ROA), bidder and target location (same country or different countries dummy), change in risk based on standard deviation and beta, a dummy variable for bidder type (bank or insurance company), a dummy variable for stock versus cash deals, and a dummy variable for public versus private targets.

The second set of models expands the first set of models to include governance characteristics of the bidders. We are limited (for this set of models) to U.S. firms because governance data from proxy statements are available only for U.S. firms. We relate bidder abnormal returns to some of the variables found to be significant in the first set of models and to variables measuring board composition and size, ownership structure, and CEO compensation.

EMPIRICAL RESULTS

Bidder Returns and Risk

Prior research on the market reaction to merger announcements is reasonably consistent. Andrade, Mitchell, and Stafford (2001) report that the average abnormal returns for 3,688 completed mergers (both financial and nonfinancial) between 1973 and 1998 is -3.8 percent among acquirers. Findings for bank mergers are similar. For example, Hawawini and Swary (1990) and Houston and Ryngaert (1994) find negative bidder abnormal returns for U.S. mergers, whereas Cybo-Ottone and Murgia (2000) find insignificant abnormal returns for bidders. DeLong (2001) reports negative bidder abnormal returns for U.S. bank mergers and reports positive combined returns for bank mergers that are both activity and geographically focusing. In addition, Houston, James, and Ryngaert (2001) find decreases in the market value of bank acquirers.

Table 3 presents the market reactions to bancassurance mergers (Panel A) and the risk shift analysis (Panel B). A number of approaches were used to obtain the event study results, and the results are consistent across models. We chose to report the abnormal returns generated using the comparison period method because this approach does not require the choice of a market index and the results are an average representation of those generated by the alternative event study models.

In Panel A of Table 3, we present bidder abnormal returns for the entire (129) sample, the (105) bank bidder sample, and the (24) insurance company bidder sample. Generally speaking, these abnormal returns indicate that bancassurance mergers yield positive abnormal returns and are thus consistent with the hypothesis that

TABLE 3
Bidder Abnormal Returns and Changes in Risk

Panel A: Event Study Results				
Sample	<i>N</i>	Event Window	Abnormal Return	Number of Positive/Negative
Full sample	129	−1	0.14%	63/66
		0	0.28%	65/64
		−1.0	0.42%	66/63
Bank bidders	105	−1	0.08%	48/57
		0	0.29%*	55/50*
		−1.0	0.37%*	56/49*
Insurance company bidders	24	−1	0.38%*	15/9**
		0	0.25%	10/14
		−1.0	0.63%	10/14

Panel B: Risk Shift Analysis				
	<i>N</i>	Preacquisition	Postacquisition	Change
Full sample	129			
Variance		0.0210	0.0205	0.0005
Beta		0.739	0.755	0.0155
Probability of failure		0.050	0.045	0.0049
Bank bidder	105			
Variance		0.0206	0.0197	0.0009
Beta		0.668	0.708	0.0408
Probability of failure		0.048	0.041	−0.007
Insurance company bidders	24			
Variance		0.0224	0.0241	−0.0020
Beta		1.054	1.119	0.0657
Probability of failure		0.055	0.062	0.007

Notes: This table shows the mean cumulative abnormal returns computed using the comparison period method, the number of positive and negative abnormal returns, the pre- and postacquisition standard deviation of returns, and the pre- and postacquisition beta for all events, for bank bidders, and for insurance company bidders. *T*-tests are performed to determine the significance of the abnormal returns, while sign tests are performed to determine the significance of the proportion of positive returns.

Statistical significance: ***1%, **5%, and *10%.

bancassurance is a viable model. The abnormal returns for the full sample are positive at 0.42 percent (days −1 and 0), but are not statistically significant. However, for the bank bidders, the 2-day abnormal return is a positive 0.37 percent and is significant (10 percent level). The insurance company bidder sample abnormal returns are positive, but only the day −1 return is significant, perhaps reflecting the small sample size. These positive bidder returns, while not large quantitatively, are striking in view of the negative bidder returns observed for financial firm bidders in most prior studies.

Although assessing the valuation effects of corporate acquisitions using event study methods is a standard technique in the literature, it is also recognized that there are a

number of limitations to this form of analysis. For example, Schipper and Thompson (1983) find positive bidder abnormal returns (up to 13 percent) for the first merger announcement in a bidder's program but no bidder reaction for subsequent merger announcements. In contrast, Asquith, Bruner, and Mullins (1983) report that most bidders make numerous acquisitions and that bidder returns are positive through the fourth acquisition. Many of the firms in our sample (approximately 48 percent) make more than one acquisition during the sample period. In light of previous empirical evidence regarding multiple acquisitions, we compare the average abnormal returns for first and second mergers within our sample. We find that first mergers ($n = 91$) result in abnormal returns of 0.20 percent, whereas second mergers ($n = 24$) result in abnormal returns of 0.59 percent. Although the positive abnormal returns on average are higher for second acquisitions, they are not statistically different ($p = 0.6401$) from those resulting from first mergers.

Panel B of Table 3 presents an analysis of potential risk changes associated with the merger announcements. These results have particular significance for the viability of the bancassurance model of financial firm architecture because regulators are concerned about the risk implications of allowing such combinations. Bank and insurance bidder pre- and postacquisition standard deviations of stock returns (calculated over the 200 days beginning 51 days prior to the announcement date) are shown, as are pre- and postacquisition betas (also calculated over the estimation period) and changes in estimated failure risk. We find that bidder risk is not altered by the merger whether the bidder is a bank or is an insurance company. Indeed, the pre- and postmerger bidder risk measures are remarkably similar. None of the changes in the risk measures is significant. These results are consistent with those of Amihud, DeLong, and Saunders (2002), who find that cross-border bank mergers have no effect on the acquirer's total or systematic risk.

Multivariate Analysis

Table 4 provides the results of four regression models of bidder returns related to transaction and firm characteristics and to changes in bidder risk associated with the merger. These four models with different variables were selected based on the potential theoretical importance of the variables and after examining the correlations among the various potential independent variables. We include as independent variables the bidder size (log of total assets), bidder profitability (ROA), whether the bidders and targets were located in the same or in different countries, changes in the standard deviation (or beta) pre- to postmerger, and dummy variables to capture whether the bidder is a bank or an insurance company, whether payment was made in stock, and whether the target was publicly held.

We find that bidder return on assets and the geographical diversification resulting from the merger are statistically significant in all models. Bidders with higher profitability (measured by ROA) appear to make the best acquisitions (as judged by the market response at the time of the merger announcement). Apparently, if bidder management has been able to obtain high profits in the past, the market believes that it will manage the target's assets well also. We consider ROA as a proxy of the quality of bidder management. It is not surprising to find that high-profit bidders are rewarded

TABLE 4
Ordinary Least-Squares Regression Models

Variable	Model 1	Model 2	Model 3	Model 4
Intercept	0.0086	0.0086	0.0088	0.0006
Bidder characteristics				
Bidder total assets (log)	-0.0001			
Bidder return on total assets	1.1673**	1.2662**	1.2393**	2.1141***
Bidder, target different country	0.0244**	0.0197**	0.0210***	0.0197***
Risk shift				
Change in standard deviation	0.1715		0.1429	
Change in beta		-0.0053		
Deal characteristics				
Bank dummy	-0.0000	-0.0011		
Stock payment dummy	0.0051			
Public target dummy	0.0013	-0.0004	-0.0005	
<i>N</i>	116	116	116	124
<i>F</i> -value	2.07*	3.00**	3.56***	12.04***
<i>p</i> -value	0.0532	0.0140	0.0090	0.0001
Adjusted <i>R</i> ²	0.0605	0.0795	0.0811	0.1511

Notes: The dependent variable is the bidder 2-day abnormal returns calculated using a comparison period approach.

Statistical significance ***1%, **5%, and *10%.

in these cases since the challenges of integrating commercial banking and insurance functions within one organization are substantial.

We also find a strong positive relation between the dummy variable that indicates the geographical diversification afforded by the merger and bidder announcement period abnormal returns. Market extension mergers are rewarded as compared to market-focusing mergers. This is particularly important and is in sharp contrast to the results of DeLong who examines mergers between commercial banks. Market extension mergers create the opportunity for enhanced geographical diversification and the associated potential to increase cash flows and possible reduction in credit risk.

Interestingly, there is no evidence that changes in risk are related to bidder returns. The coefficient estimate for the change in the standard deviation variable is positive, but it is not statistically significant. Similarly, the change in the beta coefficient variable is not significant. These results confirm the conclusions from our univariate analysis that bancassurance mergers do not lead to any significant risk shifts in the combined firms. Taken with the result for geographic diversification, the positive market reaction for market extension firms must be due to perceived opportunities for cash flow increases rather than for potential risk reduction. Our failure to find any risk changes associated with bancassurance mergers also has important implications for regulatory concerns about potential systemic risks created by these mergers.

Table 4 also provides evidence on the important issue of whether the market returns are affected by whether the bidder is a bank or an insurance company. Since most

TABLE 5
Ordinary Least-Squares Regression Models for U.S. Bidders

Variable	Model 1	Model 2	Model 3	Model 4
Intercept	−0.0020	−0.0438	−0.0249	−0.0257**
<i>Governance variables</i>				
Number of directors (log)	0.0022			
Industry board dummy	−0.0040	−0.0037		
Percentage independent board	0.0002	0.0114	0.0024	
Unaffiliated block ownership	−0.0004	−0.0008	−0.0054	
Affiliated block ownership	−0.0007			
CEO ownership	−0.0020*	−0.0022**	−0.0024***	−0.0025***
Officer & director ownership	−0.0005			
CEO compensation (log)	−0.0030			
CEO incentive pay dummy	0.0083			
<i>Control variables</i>				
Bidder total assets (log)	−0.0000	−0.0000		
Bidder return on total assets	2.5047*	2.5287**	3.0265***	3.1257***
Postprobability of failure	0.2529	0.2419		
Public target dummy	0.0094	0.0123		
Stock payment dummy	0.0114	0.0104		
N	66	66	66	66
F-value	1.63	2.57**	5.28***	10.55***
p-value	0.1015	0.0145	0.0010	0.0001
Adjusted R ²	0.1202	0.1787	0.2086	0.2272

Notes: The dependent variable is the bidder 2-day abnormal returns calculated using a comparison period approach. The sample is composed only of U.S. bidders for which governance data are available.

Statistical significance: ***1%, **5%, and *10%.

of our bank bidders are from the United States, whereas most of our insurance company bidders are European, this coefficient has significance for the viability of the bancassurance model for the future U.S. financial system. We do find that the bank dummy variable is negative in sign, but it is not significant at conventional levels. Finally, we find that neither the method of payment nor whether the target is public or private affects whether bidder returns are significant. This is in contrast to most prior research, including the findings of Fuller, Netter, and Stegemollar (2002), who report that bidders obtain positive abnormal returns when buying a private firm but lose when buying a public firm.⁷

Table 5 provides the results of a number of multivariate models for U.S. bidders. We relate bidder returns to corporate governance variables and a number of variables designed to measure bidder characteristics. The governance variables include the size of the board for the bidder, the percentage of the bidder's board that is independent, the amount of stock held by unaffiliated blockholders, the percentage held by affiliated

⁷ In all models we do not find that multicollinearity is a significant problem. We find no variance inflation factors over 2.0.

blockholders, the amount of stock held by the chief executive officer, the amount of stock held by officers and directors (excluding the CEO), and a dummy variable that takes a value of 1 if the CEO receives incentive-based compensation. These corporate governance variables are coupled with the following control variables: bidder total assets, bidder return on assets, postmerger probability of failure, and a dummy variable that indicates whether the target is public or private and whether payment was made in stock.

The governance variables in Table 5 provide some perhaps surprising results. Although most of the corporate governance variables do not approach statistical significance, the CEO ownership variable is highly significant and negative in sign. This result suggests that some CEOs with high levels of ownership are entrenched and therefore appear to make value-reducing acquisitions. Although the market views the acquisitions negatively, firm size, and with it CEO power, prestige, and non-incentive-based compensation, will increase as a result of the merger. The market appears to view mergers made by CEOs with very small equity stakes in their firms as being those with the greatest probability of success.

We also show in Table 5 that there is a significant positive relation between bidder abnormal returns and bidder ROA. This result is consistent with the results reported in Table 4. Again, the implication is that the market views acquisitions by firms that manage their resources better as being more capable of managing target assets well.

CONCLUSIONS AND IMPLICATIONS

In exploring the viability of the bancassurance model for financial firms, we provide evidence on the following questions: Are bidders in bancassurance mergers viewed positively by financial markets? If so, what factors contribute to a positive reception of bidders making bancassurance mergers? In particular, do bidder corporate governance or other firm characteristics affect market responses to these mergers? Do bancassurance mergers alter the risk profile of the bidders from pre- to postmerger?

Our evidence from a large sample of U.S. and non-U.S. bancassurance mergers provides important information relevant to these questions. In general, financial markets do respond favorably to bancassurance merger announcements. The positive bidder reactions take place with no perceived changes in the risk levels of the merged firms. The market response is influenced by the financial performance of the acquirer, by whether the merger involves expansion into a country different from the bidder's home market, and by whether there appears to be evidence of bidder CEO entrenchment (even for relatively small levels of ownership). These results are consistent with the argument that the bancassurance model for financial firms as now permitted in the United States is a viable one for well-managed bidders seeking opportunities for geographic expansion.

Although our results cannot be considered definitive, they do have potentially important implications for the evolution of the financial system. The 1989 Second Banking Coordination Directive and subsequent amendments opened up new opportunities for the expansion of bancassurance in Europe. The passage of the 1999 Gramm–Leach–Bliley Act enabled banks and insurance companies in the United States to engage in bancassurance. Our announcement-period evidence suggests that the bancassurance model is not only a legally but economically viable organizational form for certain

financial service firms. Of course, only time will tell the full bancassurance story. In this regard, an interesting area for future research would be to consider the long-run, postmerger implications of bancassurance to bidder firms.

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