Are synergies between banks and insurers hyped? Evidence from Citigroup-Travelers divestiture

A Proposal

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Research Objective

Recently, Citigroup hived off its life insurance and annuity book of business to Metlife, eight years after having it on its books as a result of its merger with the Travelers group. Given that both banking and insurance industry firms recorded positive abnormal returns surrounding the date of the merger, the purpose of this research is to study the wealth effects of the divestiture, if any, on the stockholders in these two industries. Further, the research aims to delve into the reasons behind the presence (or absence) of the wealth effects. We conclude the proposed research with a study of the current form of integration between the two major financial sector players, banks and insurers.

Introduction

Until the passage of the Gramm-Leach-Bliley Financial Services Modernization Act (FSMA henceforth) on November 12,1999 there were strong barriers restricting the entry of national commercial banks into insurance activity and vice-versa. The Bank Holding Company Act, BHCA of 1956 (and its 1970 amendments) placed severe restrictions on bank holding companies establishing separately capitalized insurance affiliates, and on insurance companies acquiring banks (Saunders, 2000). The Garn-St. Germain depository Institutions Act of 1982 enumerated these restrictions. Subsequently, commercial national banks were restricted to underwriting only credit-related life, accident, health, or unemployment insurance. They could also underwrite Directors and Officers Liability insurance but only for bank officers. Apart from these lines of insurance, these banks could not underwrite any other type of insurance, even if there were synergies available, e.g., with life and automobile accident insurance. They could however, sell insurance products in communities having a population of less than 5000 people (Felgren, 1985). On the other hand, for state chartered banks, such restrictions were progressively removed. By the late 1990s, approximately two-third of the states had given state chartered banks the right to both underwrite and sell insurance products.

Partly due to the competitive advantage granted to state chartered banks, but largely because of the Citicorp-Travelers group merger in 1998, Congress enacted the

FSMA in 1999. This Act paved the way for national commercial banks and insurance companies to enter each other's businesses, which was prohibited until then. It was posited that such deregulation would enable both banks and insurance companies to take advantage of economies of scale and scope (Berger et al., 1996, Berger 2000) resulting in a positive wealth effect for those institutions most likely to gain from FSMA. Indeed, this appeared to be the case. Carrow (2001) who studied the Citicorp-Travelers Group merger, reports that on the day of the merger stock prices of both companies soared. Citicorp recorded a jump of 26% while Travelers stock rose by 18%. Not only that, the merger had a positive impact on the stock prices of peer life insurers and large banks, both of whom recorded positive abnormal returns surrounding the date of announcement of the merger.

Eight years down the road we find that Citicorp has divested both property-liability and life insurance product lines of Travelers. The sale of Travelers Life and Annuity book of business to Metlife was recently completed. Did something go wrong? Financial theory tells us that the decision to divest "should" have been taken only if it led to shareholder value maximization. Was this the case? What happened to the benefits from deregulation hypothesis? Or was it the case that the increased competition in both banking and insurance sectors offset the gains from efficiency? What is the form of integration that is now taking place in the banking and insurance sectors? We plan to explore all these questions in our proposed research study.

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