Playing into the hands of the institutions

As the proceedings of the Hayne Royal Commission into Misconduct in Banking, Superannuation and Financial Services unfolded during 2018, there appeared hope that the Commission had embarked on a genuine 'root and branch' investigation into the structural flaws within the sector.

There is no doubt that the Royal Commission's final report has much merit with big banks and insurers coming under increased scrutiny and the hope that it will now put the banks and finance sector on the right footing to win the trust and confidence of consumers.

However, now that the final Hayne report has been released, I fear the Commission's recommendations are confined to pruning the branches only, leaving the root of many problems essentially untouched.

Two aspects of the report in relation to the life insurance industry in particular leave me perplexed. The first is that vertically integrated institutions have been left intact. This is reflected on the markets where the share prices of the vertically integrated institutions are up markedly, while mortgage brokers are down.

However, a key take-away from the Royal Commission is the ample evidence that the large institutions place shareholders ahead of their customers.

The problems for the life industry are traced back to the demutualisation of the major life companies during the 90's. Mutual life insurers were owned by their policyholders - they did not have any shareholders. Once demutualised, and ASX-listed, shareholder interests took precedence. They also became very focused on achieving short-term returns.

This set the ground for the banks to enter the industry by setting up or purchasing major life insurers and privately-owned financial planning groups. This strategy was predicated on the vertically integrated business model whereby high-margin in-house products were sold through captive or aligned distribution networks.

It is the fundamental misalignment of shareholder interests with customer interests overlaid with the vertically integrated business model that has been the root cause of most of the scandals and problems identified in the Royal Commission.

By not addressing these structural conflicts inherent within vertically integrated businesses, a golden opportunity has been missed. Commissioner Hayne has put the separation of product and advice into the too hard basket saying that doing this would "involve significant disruption to the industry", which it undoubtedly would.

The report also notes that many of the vertically integrated institutions are in the process of selling their non-banking businesses. But some of those institutions have entered into 20-year bancassurance strategic alliances with major insurers. They may have divested themselves of their assets – but not their conflicts.

Commissioner Hayne was more strident, however, in recommending that ASIC (as part of its 2021 review) consider further reducing the cap on life insurance commissions ultimately to zero, unless there is a clear justification for retaining those commissions.

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Once again, life insurance commissions have been a soft target. I understand that advocating for commissions in the current environment is not a popular view. But in my considered view, a commission deducted from premium is just another remuneration method that gives greater assurance that the client will take out the insurance.

Under the recently introduced life insurance reforms (LIF) the caps are the same for all insurers, so there is no conflict or incentive to place business with one insurer over another. In addition, advisers are bound by a best interest duty to their clients and disclosure provisions to ensure transparency.

At PPS Mutual, we adopted the commission reforms under the LIF from inception in 2016. This has meant that advisers have been receiving less commission when recommending PPS Mutual products (until 1 Jan 2020 when it will become a level playing field) - but have nevertheless continued to do so when they have considered it to be in the best interests of their clients.

Like any industry, there are good and bad apples, so you enforce targeted laws and regulations, which is what Commissioner Hayne is recommending in other sections of his report.

Reducing the commission caps will do nothing more to protect advised clients. All it will do is damage small business advisory practices and result in fewer Australians receiving high-quality insurance advice.

Commissioner Hayne notes in the report that 70% of life insurance policies are held in superannuation and is not convinced that a move away from commissions would see large numbers of Australians without appropriate cover. While he acknowledges that it may not follow that the level of cover in a super fund would be adequate, my experience is that in the vast majority of cases it is not. The cover is also inferior.

Interestingly, the removal of paying adviser commissions on Corporate superannuation plans has not resulted in lower premiums – instead premiums have increased because the adviser is not there to negotiate a better outcome. We also need to be mindful that superannuation is there to fund retirement and increasing premiums will impact on the ultimate account balance.

Receiving and acting on appropriate and adequate life insurance advice can be the most important financial decision an individual will ever make.

The scenario above will once again play into the hands of the big banks and insurers. This is because their own in-house captive distribution networks and strategic alliance partners do not have to compete with a strong and vibrant non-aligned adviser force.

Hopefully ASIC, which has been tasked with reviewing the commission caps in 2021, will take these factors and the impact on society of losing non-aligned advisers into careful consideration. It is a big concern that less advisers will pave the way for more consumers being underinsured and vulnerable.

About Michael Pillemer & PPS Mutual

Michael Pillemer has spent over 30 years in the financial services industry. In 2002 he co-founded and was CEO of Centric Wealth which was an early mover of fee-for-service financial planning and investment advice and became one of Australia's largest privately-owned wealth advisory businesses with $5 billion under advice. He is currently Chief Executive of PPS Mutual, a mutual provider of insurance products to professionals such as accountants, doctors and lawyers. The business is based on the 75-year-old South African mutual, called PPS. PPS Mutual has no ownership links to financial advisers and is owned by its Members who are the lives insured under the PPS Mutual policies. Each year, PPS Mutual Members are assigned a share of the annual profit generated by the PPS Mutual products. Both companies were set up to compete with the incumbent institutions by providing a better alignment of interests between the company and its customers.