Association of
Financial Advisers

Analysis of Royal Commission Recommendation on Life Insurance Commissions

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Now that the dust has started to settle on the Royal Commission final report it is timely to reflect upon what the report said about Life Insurance Commissions. The final recommendation was to let the 2021 ASIC review play out as previously committed by the Government, however the Commissioner expressed a clear bias for further reductions in commissions.

The discussion on life insurance commissions was brief, going for just four pages from page 185 through to the recommendation on page 189. The report starts with a reference to the exception for life risk insurance commissions receiving attention during the hearings. This is somewhat surprising, as there was only one prominent case that referred to life insurance advice, which was the couple who received advice to set up an SMSF and buy a Bed & Breakfast. The life insurance advice was incidental to the SMSF advice, although the overall case was clearly disturbing enough to be included as an example in the FASEA Code of Ethics.

The final report uses an entire page to list the commissions paid over a period of five years for life insurance advice. $6.1 Billion is a large number, although this is $1.2 Billion per year and when looked at in terms of the average amount per adviser authorised to provide life insurance advice is only around $65,000 per year. The use of the $6.1 Billion figure is deliberate and repeats the opening statement to the Insurance round back in September. The AFA challenged this back in our Insurance round submission. It is a bit like saying that the total Medicare benefit payments to doctors and medical service providers was $23 Billion in 2017/18. On its own, this total Medicare benefit number has limited relevance to what happens at the individual level.

The report then goes on to incorrectly describe the LIF model. Page 186 and 187 includes the following:

"From 1 January 2018, conflicted remuneration includes volume-based benefits given to a licensee or representative in relation to information given on, or dealing in, a life risk insurance product. A monetary benefit relating to a life risk product ***will not be conflicted remuneration if it is a level commission within the applicable cap and provides a 'clawback' arrangement*** *if the policy is cancelled, not continued, or the policy cost is reduced in the first two years of the policy."*

The clear error is in the suggestion that the cap and clawback arrangement applies to level commission business. It does not. The LIF model applies to upfront commission arrangements only. We were certainly surprised to see this error, particularly given that the AFA had pointed out the exact same error in our response to the interim report (see page 33 and 34 of the AFA submission in response to the interim report). Unfortunately, this was just one of a number of errors in the interim report that were repeated in the final report.

The report then states that they received few submissions in response to the interim report that were calling for further changes to the LIF arrangements. Obviously, groups like the ISA, Choice and the FSU did call for a total ban of life insurance commissions, however the vast majority favoured letting the 2021 review play out. The Commissioner noted that underinsurance was used as an argument for retaining life

insurance commissions, however, he is clearly not sold on this argument. His counter argument is that the overwhelming majority of life insurance policies are held through superannuation. He is clearly referring to Group Superannuation arrangements in this section, not appreciating that they only represent a very small number of policies (as individual members do not have their own policy), even if they do represent a large number of members. He refers to more than 70% of life policies held in this way. Whilst group super may represent 70% of lives covered, APRA statistics suggest that it only represents 62% of insurance cover as the average level of cover is much lower. He also fails to state that the retail advised product is a much better product (i.e. own occupation, terms and conditions, guaranteed renewable etc. etc.). His argument also fails to take into account the likely consequences of the Government's Protecting Your Future Package, which KPMG estimated would reduce the level of group super cover by 50%. This legislation was passed in the Senate last week, although the small balances (under $6,000) and the under 25 years of age elements have been left out, at this stage. The removal of insurance for inactive accounts will result in a material reduction in the level of cover in group superannuation, which will impact the assessment of underinsurance.

A focus upon lives insured is not the only measure of importance, and surely the amount paid out in claims is even more important in delivering the right outcome for consumers. This should be measured in terms of money in the hands of clients and take into account the leakage that goes to lawyers assisting with insurance claims. In our Insurance Round submission, we invited the Royal Commission to recommend a cap on these fees paid to lawyers. Unfortunately, there was no take-up of this suggestion.

The Commissioner accepts that members of group super funds do not have the same level of cover as advised clients, however then he goes on to strangely suggest that he is not convinced that this would leave large numbers of Australians without an appropriate level of life insurance. Clearly the Royal Commission needed to do more work in this space, however we cannot expect them to be experts on everything.

The Commissioner then goes on to say that if the 2021 review indicates that the LIF caps do not contribute (or at least not significantly contribute) to underinsurance then ASIC should continue reducing the caps – ultimately to zero. This highlights further errors and misunderstandings. Firstly, ASIC only has powers to reduce the commissions on upfront (LIF) business. They do not have any power to alter the level commission arrangements. Secondly, a quick check with a few life insurers would no doubt clarify the impact that LIF had in 2018, with a material reduction in new business. Probably the most alarming thing is the implication that if going to 60% will not have much impact, then going to zero will have a similar impact. Many financial advisers will find it challenging with a 60% upfront commission rate. If it went to zero, they will simply leave, and leave in droves. We can only imagine what a devastating impact that this would have on the state of underinsurance.

He concludes that any decision should be based upon clear evidence that the harm that would flow from abolishing commissions would outweigh the harm that already flows from allowing this form of conflicted remuneration to continue. We can only wonder what he bases this judgement on. We could easily respond by saying that ASIC Report 413 revealed a 93% pass result for hybrid commissions, which was a higher commission rate than we have now. It seems that this ideological determination to eliminate all conflicted remuneration is contributing to statements without justification or evidential support. There is a much stronger basis to say that there is little harm done to clients as a result of life insurance commissions and that the Royal Commission provided nothing to prove otherwise.

The 2021 review was previously going to focus upon the quality of advice. It seems that it will now need to also focus upon the level of underinsurance. It will be important to ensure that the industry prepares well in advance of this timeframe and that we must clearly articulate the value of retail advised life insurance and the importance of commissions in making quality life insurance available to all Australians.