Op-Ed: Ensuring the sustainability of life insurance advice

March, 2019:

By Sean McCormack, Chief of Group and Retail Partners, MLC Life Insurance

Commissions in question

Following the release of the Royal Commission's final report, I have received a number of messages from concerned financial advisers regarding the recommendation to reduce life insurance commissions to zero following ASIC's review of the Life Insurance Framework (LIF) in 2021.

While advisers and others within the industry acknowledge the headline recommendation, it's debatable whether underinsurance should be the anchor for the 2021 ASIC review. After all, the LIF reforms that took effect in 2018 were intended to improve the quality of advice by addressing the findings of ASIC Report 413 (Review of retail life insurance advice). This would presumably be an appropriate and worthy focus of ASIC's review.

Despite this, the question of whether commissions should continue is a question that warrants serious consideration. As an industry, we must ask ourselves what the future of advised life insurance might look like without commissions. Will clients be better off as a result?

From the outset, my view is that client interests have to come first. Given today's trust deficit in Australian financial services, this is fundamental to any discussion on the future of remuneration models, including commissions.

Scrutiny of life insurance commissions is nothing new. ASIC Report 413 revealed that 96% of the poor advice identified was provided by advisers who received an upfront commission. Following a number of reviews, the implementation of LIF commenced a phased reduction in up front commission levels. As a result, most life insurance advisers have now transitioned their businesses from upfront to hybrid commission models. There has also been a growing trend from a small number of advisers to an arrangement where they are remunerated through a combination of both commissions and fees.

While understanding the challenges facing many advisers, MLC Life Insurance supports the objectives of LIF. It strikes a reasonable balance between addressing the client risks of conflicted remuneration, while keeping life insurance advice affordable and accessible for all Australians, especially those on middle and fixed incomes.

We strongly believe in quality, lifelong financial advice and believe more Australians would benefit from receiving it. Research shows that nearly 80% of Australians who receive advice feel greater peace of mind as a result[1]. Further, 50% of people who have received advice believe they could survive financially for more than six months if they were unable to work, whereas only 26% of people who have not could say the same.[2] At the moment only 20 per cent of Australians receive advice, which means an alarming 80 per cent do not[3].

Advice, commissions and lives insured

[1] Great Advice for More Australians White Paper - Association of Financial Advisers (AFA). The White Paper is based on a survey of 946 people between 14 August 2018 and 3 October 2018.
[2] As above
[3] Roy Morgan, 2018

However, while we support the LIF review in 2021 we fear that, without a robust alternative model, reducing commissions to zero has the potential to make advised life insurance unsustainable. Perversely, this could actually increase the risk of Australians relying on insurance arrangements that are not optimised for their circumstances. Moreover, because it is likely only those Australians who are prepared to pay some kind of fee that will receive life insurance advice, those with lesser economic means will be most affected.

We believe life insurance provides an important social and community benefit. However, often people require prompting from an adviser to understand the benefits to them and their families. Unless confronted with the prospects of their own mortality or morbidity by an adviser, or unless they are defaulted into group insurance through superannuation, few Australians will take out insurance through their own volition.

While reporting on commissions is mostly negative, the truth is that clients are served in some way by them because they offset the cost to access financial advice. Like any professional service providers, advisers who provide value to clients deserve to be adequately compensated for their time, service and expertise. Without a commission model, the logical alternative is for the client to pay a fee. The real question is whether clients would embrace such a model. If they don't, the question is whether this results in detriment to the client as they are not able to afford the advice they intended to receive and they are not appropriately insured.

Good life insurance advice is valuable

According to research from the Financial Planning Association, it takes an adviser around 26 hours to help their client obtain life insurance cover. Advisers must assist and educate them to understand their own situation and needs, produce a formal statement of advice, obtain quotes and, ultimately, implement their cover. If a client were to pay by the hour, it could end up costing somewhere between $3,000 to $6,000[4]. How likely is a new client prepared to pay such a fee? In addition, insurance terms are only provided once the application is assessed. How many clients would be prepared to pay a fee for advice if they don't receive satisfactory terms?

And this cost covers just the up-front advice. Good advice doesn't stop once a client gets cover. Often absent from the commissions debate is the important, ongoing support advisers provide to their clients. This work goes to the heart of what represents good advice. Good advisers regularly review their clients' insurance needs. They liaise with insurers on their behalf to adapt and administer their policy. Critically, they support the client when making a claim, advocating on their behalf to the insurer as well as helping them obtain and provide accurate information and supporting documentation. Many clients will testify to the invaluable practical and emotional support advisers provide during these difficult times. In a potential post-commission world, who meets this cost?

Advisers can't do this work without payment and expect to run a sustainable business. This is what renewal commissions paid by insurers recognise. Unfortunately, such commissions are often characterised as a passive income stream for advisers that elicits no further advice or service to justify it. It is though critical that renewal commissions are accompanied with ongoing services to avoid passive income being received and no services provided to advised clients.

The future of commissions and potential solutions

What will happen if commissions are reduced to zero?

Interestingly, this issue was contemplated as part of the UK's Retail Distribution Review in 2013. As part of this, commissions were removed from investment advice; however they were retained for life

[4] Mapping fintech to the financial planning process: FPA report

MLC Limited
ABN 90 000 000 402
AFSL 230694

Level 7, 40 Mount Street, North Sydney NSW 2060 Australia

727 Collins Street Docklands VIC 3008 Australia

PO Box 200 North Sydney NSW 2059 Australia

mlcinsurance.com.au

insurance. This was because it was acknowledged that life insurance was in the national interest. In other words, they acknowledged that insurance was a reluctant purchase.

While there are differences between Australia and the UK, we are concerned about the potential reduction of commissions to zero. Ultimately, we're in favour of a robust system that gets good insurance solutions into clients' hands, and allows advisers to make a reasonable and sustainable income. Currently, commissions play a part in that model however, if we're going to move away from them, then we need to be very clear about how the new system is going to work. It is not clear at the moment what that new system looks like or how it will work.

We urge government to carefully consider the way in which this recommendation is implemented. If there are to be changes to commissions, any alternative model has to be viable for both clients and advisers.

Our recommendation is to put the client in control and offer choice.

Where a client wants to have the cost of their upfront advice offset by commissions, and to keep commissions in place to ensure ongoing support from their adviser over the life of their policy, they should be able to do so.

However, if clients are comfortable to pay a fee, product manufacturers should provide a reduction in premiums that reflects the lower cost to them when commissions are removed. This reduction should be both upfront and ongoing.

In this way, education, transparency and ongoing service become more important to ensure clients make an informed decision before deciding how they pay for insurance and related advice.

MLC Life Insurance believes that Australians are better off with access to good, ongoing financial advice, and we support a sustainable advice sector in which commissions currently play an important role. Shortly we will commence extensive research into the true cost of providing life insurance advice, and will be sharing the findings with government and stakeholders to help shape this important issue.

MLC Limited
ABN 90 000 000 402
AFSL 230694

Level 7, 40 Mount Street, North Sydney NSW 2060 Australia

727 Collins Street Docklands VIC 3008 Australia

PO Box 200 North Sydney NSW 2059 Australia

mlcinsurance.com.au