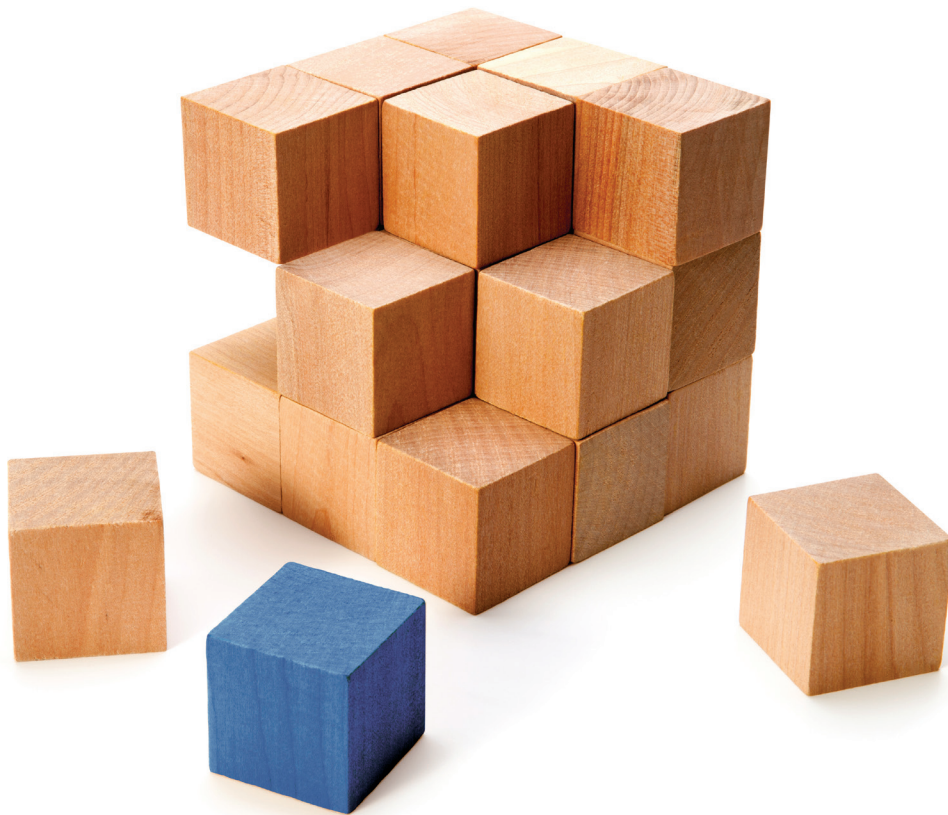
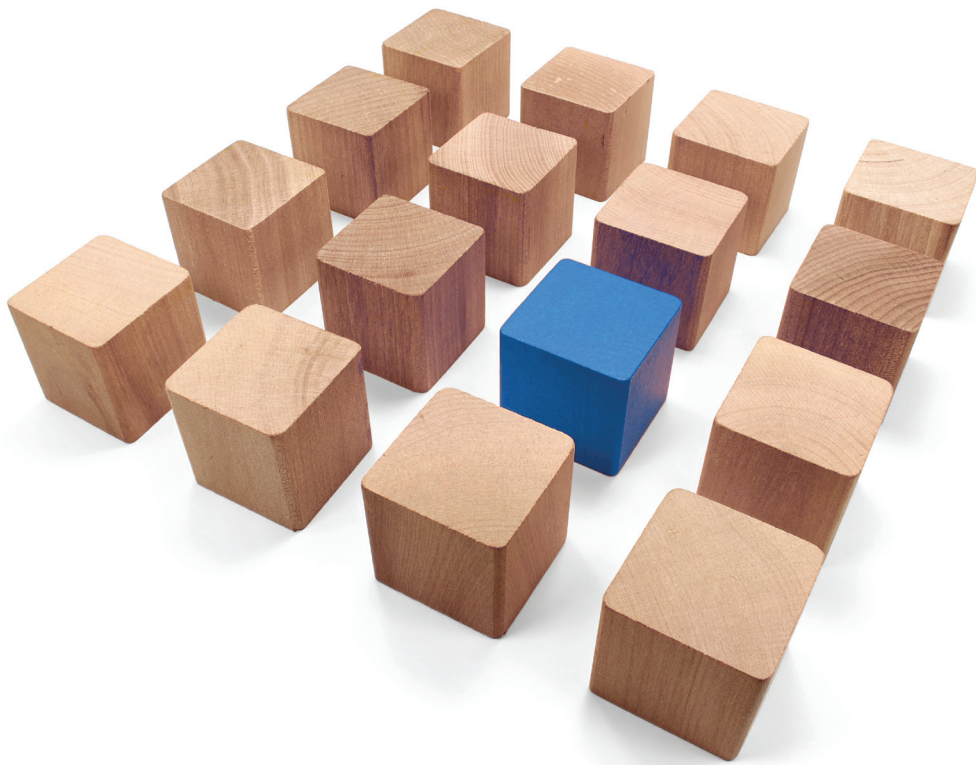


# The Risk Advice Disconnect

Briefing paper – life insurance commissions.





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# Introduction

The topic of life insurance commissions has long elicited a diverse range of views. This proved especially true during the recent Royal Commission into the banking and financial services sectors.

Throughout the program of seven hearings, the role of remuneration structures in various categories of 'misconduct' was examined in depth by the Commission. Media coverage was predictably one sided, running the traditional line that commissions are inherently conflicted and therefore inherently contrary to the best interests of consumers. This view was expressed in relation to commissions of all type, including life insurance commissions, mortgage broker commissions, and grandfathered trailing commissions.

Zurich has long supported the view that:

- Expert financial advice across complex categories such as life insurance is of enormous value;
- Advisers should be paid fairly for the cost of providing advice at the time they provide it;
- Consumers should have a choice in how they are able to pay for that advice;
- Commissions play a vital role in allowing the everyday consumer to be able to access advice.

Furthermore, Zurich has long rejected the view that life insurance commissions are disliked and mistrusted by all consumers, believing instead a significant proportion prefer – when given the choice - this method of remunerating their adviser.

Zurich made a submission along these lines in response to the Round 6 (Insurance) hearings of the Royal Commission.

That submission referred to research we had conducted as far back as 2010 that examined consumer attitudes to life insurance commissions.

Subsequent to that submission, Zurich engaged the highly respected research consultants, Rice Warner, to conduct an up – to – date examination of this same topic.

This report summarises their key findings, along with other relevant research conducted by Zurich throughout its global network.

## Source documents used in producing this paper

*'Impact of banning commissions on Life Insurance policies':*  
Rice Warner, 2018.

*'The Life Insurance Literacy Gap':*  
Zurich & Core Data, 2015.

*'The Income Protection Gap':*  
Zurich/Oxford University, 2016.

*'Australians, mis-informed, mis-insured':*  
Zurich 2014.

*Zurich response to Round 6 policy questions:*

Royal Commission into Misconduct in the superannuation and financial services industry: October 2018.

# Insurance literacy and the need for advice

In 2014 Zurich released its whitepaper *'Australians, mis-informed, mis-insured?'*, a pioneering research project which revealed low levels of understanding around life insurance and other insurance and non-insurance support mechanisms (e.g. health insurance, travel insurance, the NDIS, workcover).

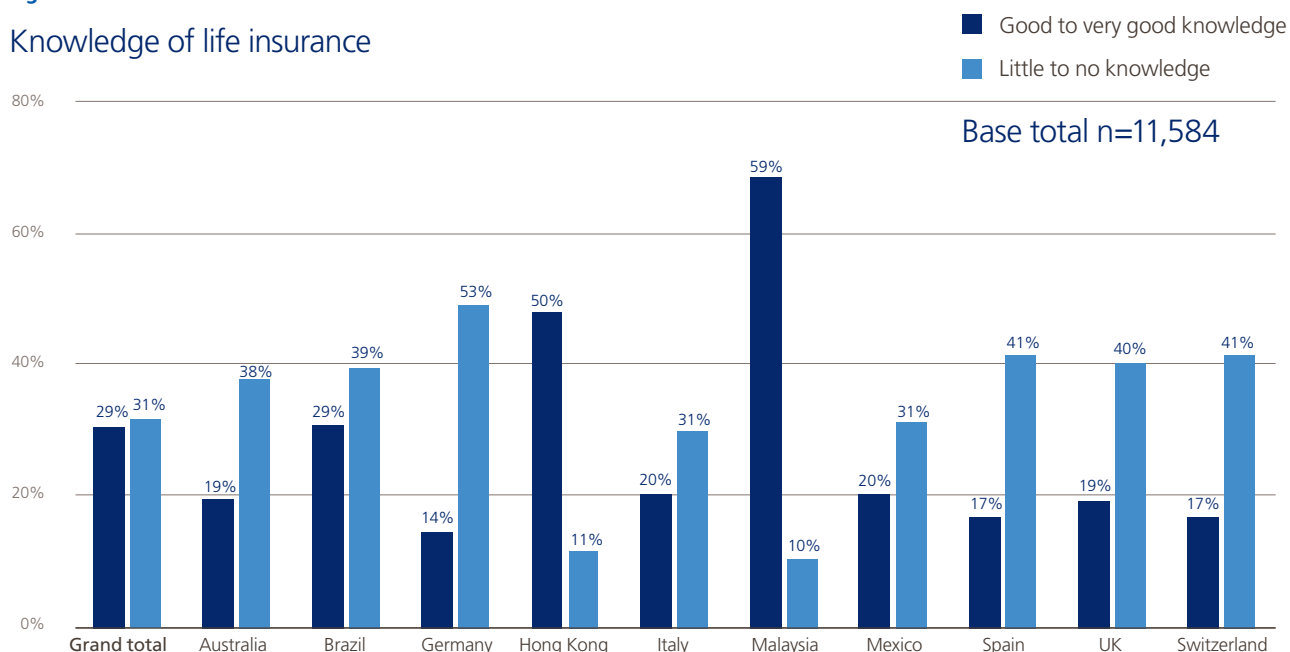
Several subsequent Zurich research projects, including the *'Life Insurance Literacy Gap'* co-published with the FPA, and the *'Income Protection Gap'*, conducted in conjunction with Oxford University, have all found similar trends:

- Australian life insurance literacy (understanding of life insurance products and coverage) is low by world standards; and
- Australians who receive financial advice are considerably more likely to have 'excellent' literacy levels, including
  - Understanding the events they are covered for
  - Understanding the tax treatment of life insurance
  - Understanding what they pay for cover.



Figure 1

## Knowledge of life insurance



## Advisers are seen as the most reliable source of life insurance help

Given the low levels of life insurance literacy already described, the proportion of consumers who are equipped to effectively 'self help' online is small. Unsurprisingly, many need expert help.

Oxford University research found that in Australia independent financial advisers were the preferred source of that expert help.

**Figure 2**  
Preferred source of advice about life insurance

	INDEX
Independent financial advice	1,0
Comparison website	0,7
Consumer protection & advocacy organisations	0,7

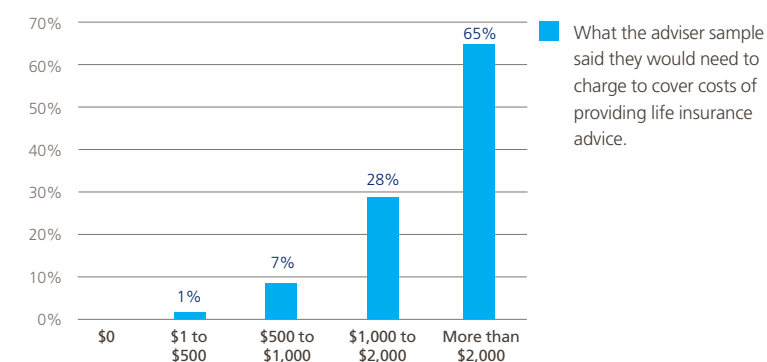
Base working community n=1031

## But the cost of advice is a barrier

Even the most basic life insurance advice can take at least 8 hours of preparation time. Charging this at a market average margin can easily see this advice cost \$2,000 or more.

Indeed, Rice Warner surveyed advisers about what they would need to charge as an out of pocket fee for life insurance advice, and found almost two thirds would need to charge \$2,000 or more. Only 1% said that they could charge less than \$500 (although even this is possibly overstated).

**Figure 3**  
Cost to provide advice

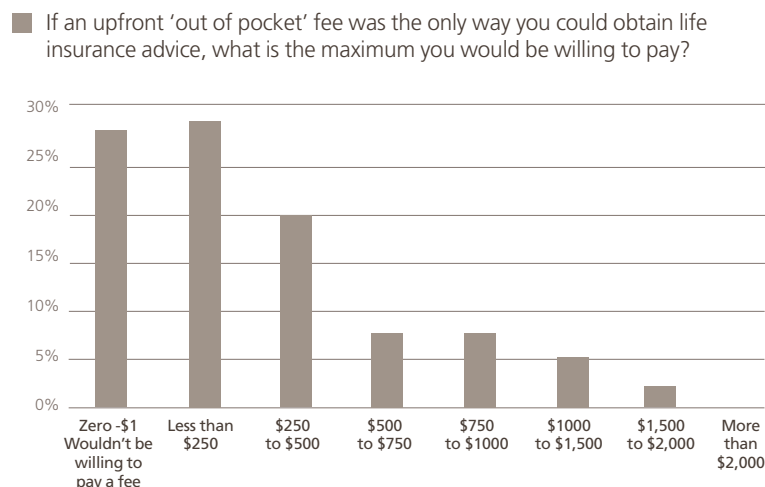


## The gap: cost to provide v willingness to pay

When consumers were asked about their willingness to pay an out of pocket fee for life insurance advice, there was an alarming – although unsurprising – disconnect between what they would pay and what they would need to pay.

**78% of consumers said they would only be willing to pay \$500 or less (28% unwilling to pay a fee at all), and none were willing to pay \$2,000 (or more).**

**Figure 4**  
What consumers are willing to pay for life insurance advice

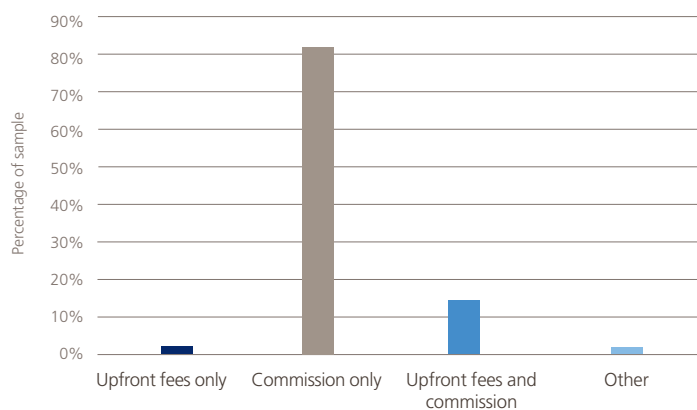


## How do consumers pay for advice now?

Commission is the most common way consumers pay for advice, with over 80% of advisers charging in this way

The popularity of the 'commission only' option is unsurprising, as it eliminates the need to find a substantial amount of money – \$2,000 or more – to fund an upfront fee out of their own pocket.

**Figure 5**  
Advice payment trends



## How do Australian commissions compare?

By world standards, Australian upfront commissions are low.



**Figure 6**  
Commissions around the world

Country	Up Front % (typical)	Renewal % (typical)	Comments
<b>AUSTRALIA</b>	80 (60% by 2020)	20	
<b>US</b>	70–120	NA	Commission increases with length of term
<b>UK</b>	200+	2.5%	Up front can be as high as 250%
<b>NZ</b>	150–180	5–10	One provider paid 230%
<b>IRELAND</b>	15 x length of term, s.t max of 150% (paid 100 Y1 & 50 Y2)	3	UK and Ireland tend to have fixed term contracts, not guaranteed renewable to age 99 like Australia
<b>JAPAN</b>	115	58.5 paid over next 9 years	Capped at 173.5% over 10 Years
<b>GERMANY</b>	98	2	

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## An international perspective - extract from Rice Warner Report for Zurich

Financial services such as life insurance are not provided in a global market and comparisons across different countries should consider structural differences including legislation, culture, distribution channels, product combinations and taxation. Because of such differences, international perspectives on life insurance commission regulation should be used with caution. Acknowledging those differences though, we offer some brief observations from other life insurance markets.

It is common in many markets for regulators to have implemented measures to improve the quality of financial advice and to reduce potential conflicts of interest between consumers and their advisers. These often mirror Australia's FOFA reforms with measures to align interests, improve disclosure and to reduce conflicts of interest inherent in remuneration structures for advisers and other distributors.

Commissions remain the typical model of paying for life insurance advice in most developed economies. In the United Kingdom, the Retail Distribution Review took a similar path to FOFA. While this resulted in a ban on financial product commissions, similar to FOFA, protection only life insurance was exempted from this ban.

*Many other jurisdictions have openly considered bans on financial services commissions in recent years, including South Africa, Singapore and Hong Kong. In all cases, commission bans were not deemed appropriate given concerns about the impact upon the volume of advice that would be given and the volume of life insurance that would be purchased. Many studies cited the unwillingness of consumers to pay for advice from their own pockets up-front, compared to the willingness to accept higher ongoing premiums to finance commissions.*

We did identify three developed nations however that have banned commissions on life insurance, being Finland (2005 with a three year transition period), Denmark (2006 with a five year transition period) and the Netherlands (2013). In each of these cases, studies have shown a reduction in the number of intermediaries that are most equivalent in those markets to the role

that financial advisers play in Australia. Typically, these intermediaries are referred to as brokers and studies have shown reduction in their numbers in the years following implementation ranging from approximately 15% up to 30%.

As an example of the difficulty of comparing across different legislations, the Trowbridge Review noted that approximately 90% of life insurance purchases in the Netherlands are tied to mortgages which can only be accessed by those with a life insurance policy. Hence, only 10% of life insurance purchases are considered to be discretionary and those discretionary purchases did reduce approximately 30% upon implementation in 2013. Overall this equates to a 3% reduction in life insurance purchases, however it would be clearly incorrect to extrapolate that 3% reduction as an indication of the likely impact of an equivalent ban in Australia, where the significant majority of life insurance purchases are discretionary.



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# Consumer attitudes to commissions

## Overall attitudes

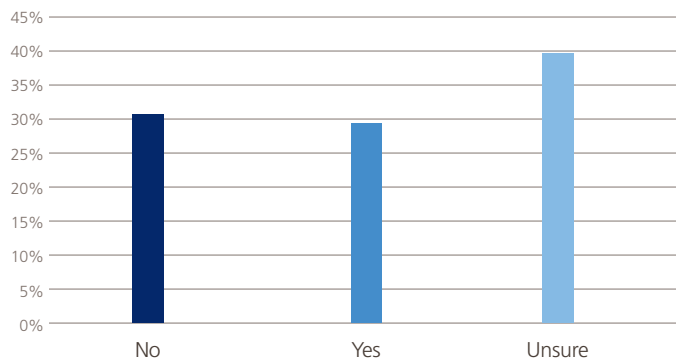
In examining consumer attitudes to commissions as a way of paying for life insurance advice, a series of questions was asked to 1,000 randomly selected consumers. Each subsequent question dug deeper to try and understand these attitudes. Through this process it became apparent that overall attitudes started off as neutral towards commission, and then became more supportive once respondents were able to put the topic in context of other available options. In other words, once they were asked to imagine that commissions were no longer available as an option, their true support for that option became apparent.

This story is told in the following charts.



Are commissions a fair and appropriate way for financial advisers to be remunerated when providing life insurance advice?

**Figure 7**  
Are commissions a fair way to pay for advice?



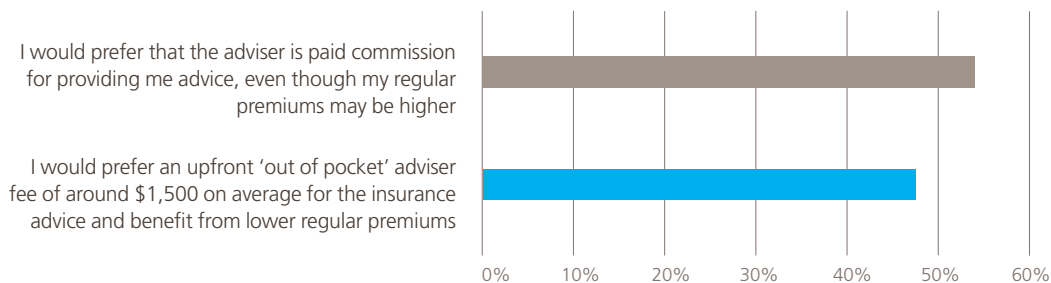
The first question was designed to gauge their initial, instinctive view.

When they were then presented with a scenario where they could either pay for their life insurance advice via an upfront fee, or via commission (and a loaded premium), support for commissions strengthened significantly.

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\$1,500 fee v commission?

**Figure 8**  
Fee or commission?



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## Can we believe these figures? (remember the gap)

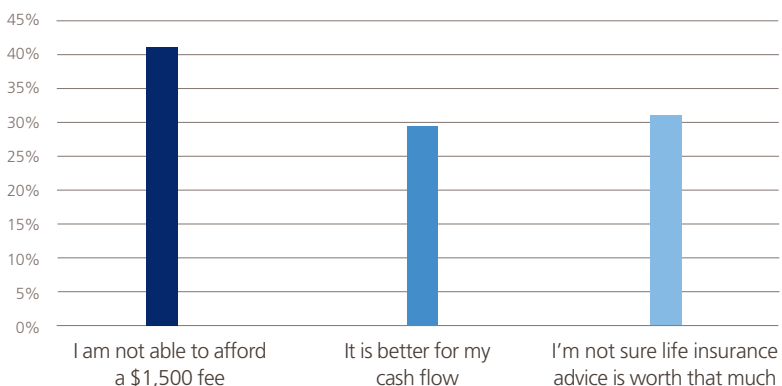
Taking into account the previous findings about the size of fees respondents said they were willing to pay, it is likely that the proportion that chose the commission option in this scenario (55%) is significantly understated. (As shown in Figure 4, only 5% said they would pay a fee of \$1,000 to \$1500 and 3% said they would pay \$1500 to \$2000.

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For those preferring commissions, the reasons are as expected



**Figure 9**  
Why do you prefer commissions?



Close to 70% indicated their preference was related their cash flow or ability to pay. This is hardly surprising given the lifestage where consumers are most likely to need life cover (mortgage, children) often coincides with their peak indebtedness and lowest ability to pay.

The remaining 30% were uncertain about the value of life insurance advice, a response hinting at one of the advice profession's most enduring challenges – having people understand the true value of advice.

### Only pay when you buy

Another disadvantage of the fee approach for consumers is that a fee is payable for the advice regardless of whether they go on to purchase life insurance.



## Amongst those preferring fees, a common theme emerged

Amongst the verbatim comments from consumers around their preference for fees over commission, one particular theme emerged – the idea that the commission amount would influence the insurance product recommended:

“They will be biased to the highest paying provider!”

“Because the broker would really only promote the company that pays the best commission”

“I think no because it seems as they might push you toward a life insurance company which provides higher commissions”

“I am worried that I would get biased advice based on what company pays the better commission to advisers”

This major objection was of course rendered irrelevant with the introduction of the LIF framework and standardised commission rates across all providers. Clearly more needs to be done to have this understood.



## How do consumers react when an upfront fee is mandatory?

Previous Zurich research (from 2010) revealed a substantial proportion of consumers, if an upfront fee was the only way to pay for life insurance advice, would simply leave the market altogether.

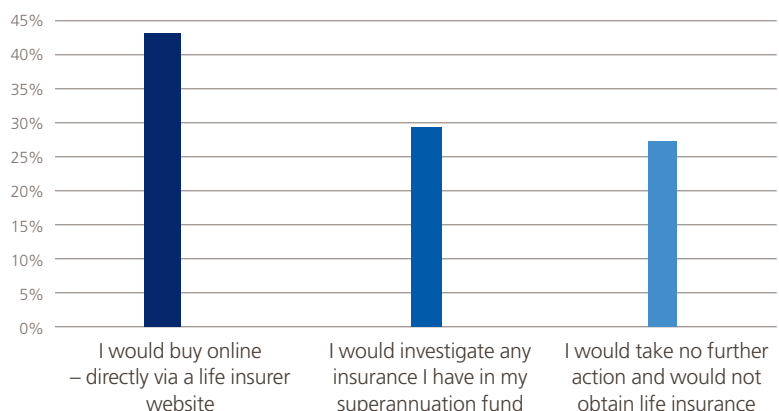
Updating this research we found a similar result, with close to 30% indicating they would simply exit the market altogether. Just over 40% indicated they would look to purchase cover directly and just under 30% said they would investigate increasing cover through their superannuation fund.

To the extent that these latter two options are self directed, involving no expert assistance, there is an increased likelihood of people taking out inappropriate types – and amounts – of cover.

Both underinsurance and misinsurance would be exacerbated.

Figure 10

If you could not afford the upfront ‘out of pocket fee’ for insurance advice, what would you do?



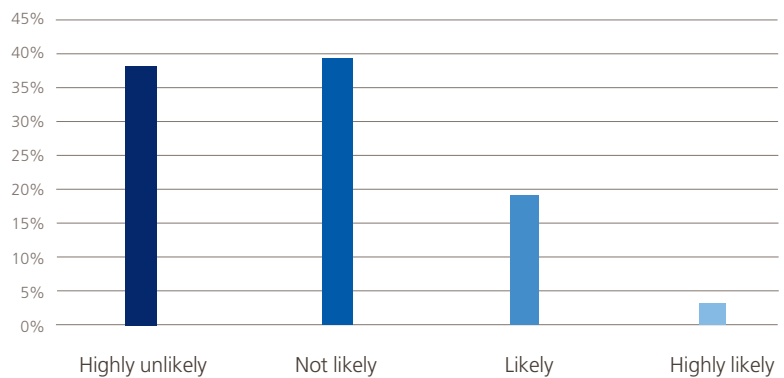


Would consumers pay for roboadvice?

Put simply, it is unlikely.

**Figure 11**

How likely is it that you would be willing to pay an upfront 'out of pocket fee' to use an automated online advice tool instead of paying for tailored advice upfront?



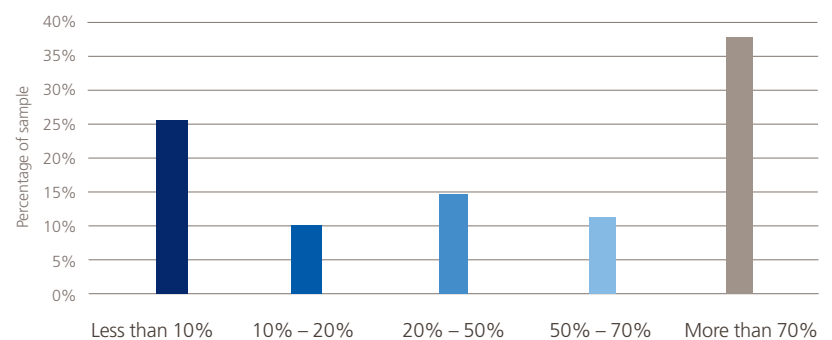
### Commissions do not drive overselling

As the saying goes, 'life insurance is sold, not bought'. And whilst to an extent it remains true that many consumers don't immediately understand the value of or need for cover, the fact is that a significant number of people proactively approach financial advisers for the purpose of seeking life insurance.

When considered in context of the rigorous advice processes seen across the market, our view remains that commissions for life insurance advice do not drive 'overselling'.

**Figure 12**

What proportion of your clients come to you with the primary purpose of seeking life insurance advice, rather than it being something you suggest to them?



The Royal Commission questioned whether life commissions should remain exempt from the FOFA ban on conflicted remuneration.

Here is our response:

“Zurich believes that commissions payable to qualified financial advisers in respect of life insurance advice that satisfy the LIF requirements should continue to be exempt, in that they are designed to ensure that the commissions do not in themselves drive adviser behaviour that is contrary to consumer interests or expectations.

When comparing the basis for the FOFA ban on commissions in respect of investment products with a possible life insurance commission ban, it is clear that there are several important differences, as summarised in the table opposite.”

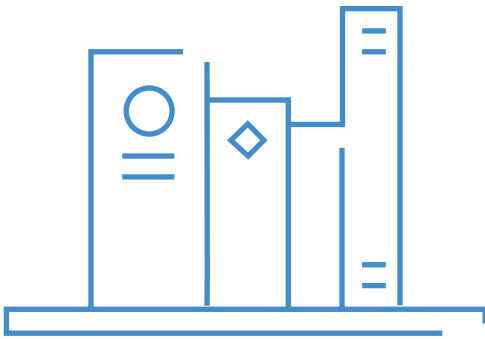




**Figure 13**  
Differences between pre FOFA investment advice and risk advice

Investment products advice	Life insurance advice
<p>There were an enormous number and variety of products in which consumers could invest (ranging from high risk agribusiness schemes, unlisted property and share listings, through to highly regulated, highly liquid unit trusts and managed funds), most of which were either unknown or poorly understood by consumers</p>	<p>Retail life insurance products are generally comparable in nature and there is a limited number of products and insurers to choose from</p>
<p>There was a significant divergence in commission amounts payable between these options, usually with a correlation between the investment risk and the amount of commission payable</p>	<p>Commission levels are standardised and there is no financial incentive for advisers to recommend one product – or one insurer – over another</p>
<p>In most cases the consumer was not actively seeking to invest in specific investment products</p>	<p>A significant number of consumers are actively seeking guidance around life insurance</p>





## our response continued:

The main 'conflict' identified as previously applying to life insurance related to the potential for up – front commissions to encourage inappropriate/premature replacement of policies. The LIF framework contains provisions to cap commissions at 60% and extend the responsibility period, along with new lapse reporting requirements which highlight instances of excessive replacement transactions. Early evidence that these measures are proving effective in eradicating the already limited instances of such behaviour is encouraging.

Zurich's own research into consumer attitude towards commissions, along with similar international studies reveal that a significant proportion of consumers are supportive of commissions as a way of paying for advice.

We believe commissions should continue to be allowable within the limits specified in the LIF regime.

Furthermore we believe that advisers should be able to be adequately remunerated for the cost of providing advice at the time they provide it.

For this reason we would not be supportive of any reduction in the commission caps below those already contained within the LIF framework.

**Any move to reduce commissions below this level, or even ban them altogether, will significantly impede the ability of consumers to access and afford life insurance advice.**

Advisers help deliver better life insurance outcomes for their clients in several important ways:

- Selection of cover types and levels that best suit their circumstances;
- Helping them understand what cover they have and how it works;
- Guidance through the application and underwriting process helps minimise disclosure issues;
- Guidance as to whether a claimable event has happened and assistance through the claims process.

The consequences of limiting access to life insurance advice are thus significant. A small number of consumers may choose to purchase life insurance without enjoying the above benefits of advice, whilst the majority are likely to exit the market altogether and remain without the protection they sought.

Zurich notes that the LIF framework is due to be reviewed by ASIC in 2021. We urge the government to stick to this schedule.

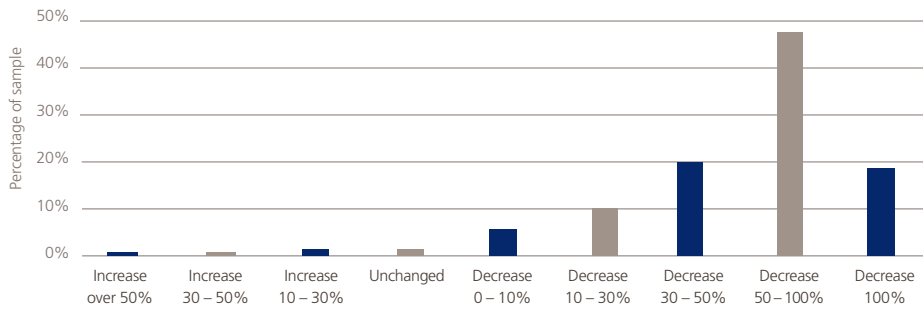
## Reducing the supply of advice

Restricting or even banning life insurance commissions would impact not only the ability of average Australians to access life insurance (products and advice), it would likely also have the effect of significantly reducing the supply of that advice.

Our survey of 250 advisers active in the life insurance space revealed the potentially devastating impacts on their business and their employees.

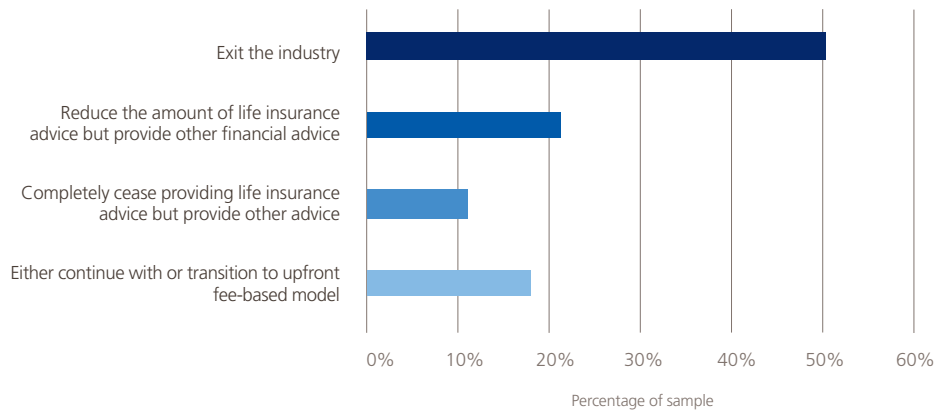
**Figure 14**

If an upfront fee-based model was mandated for providing life insurance advice, how do you think your business' revenue from insurance advice would be impacted?



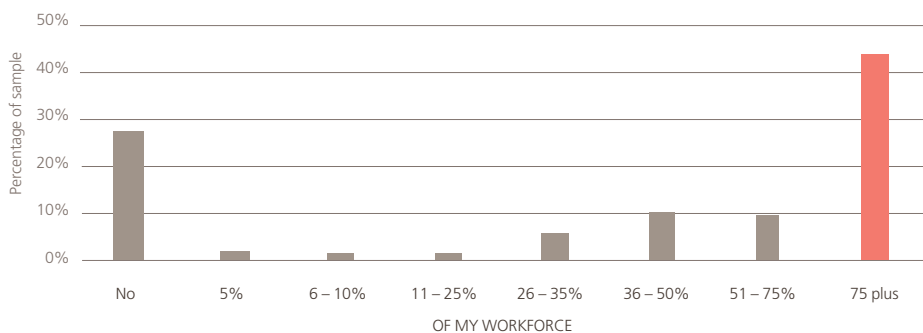
**Figure 15**

If an upfront fee-based model was mandated for providing life insurance advice, what action would you take?



**Figure 16**

If an upfront fee-based model was mandated for providing life insurance advice, would there be any job losses in your practice?



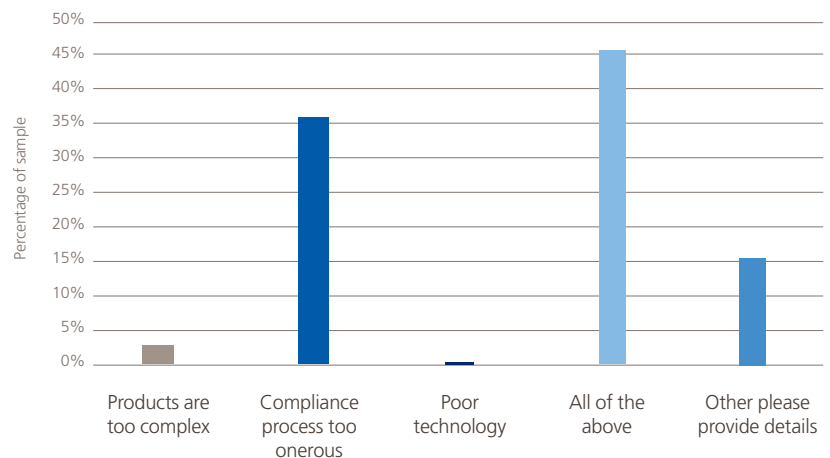


## Can advice be made cheaper?

Many advisers believe their hands are tied in terms of creating meaningful downward pressure on the cost of advice. Onerous compliance processes were highlighted as the single biggest contributor to costs, along with technology and product complexity. Close to 80% of those surveyed felt a combination of these reasons represented a significant barrier to bringing the cost of advice down.

Figure 17

What do you think is the biggest barrier to being able to offer advice at a lower cost?



## The macroeconomic impact

Based on the adviser survey results, Rice Warner modeled an economic impact based on a 50% reduction in the amount of advised life insurance sales. Their modeling found the subsequent reduction in claims paid each year saw an annual reduction in spending capacity of nearly \$2.4 billion.

An annual loss of tax revenue of \$2.65m and increased social security payments of \$70m could also be expected.

Annual reduction  
in spending of   
**\$2.385** BILLION



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## Summary

In summary we believe commissions play a valuable role in maximising the ability of consumers to access expert advice when purchasing life insurance.

We find many of the perceptions about commissions – their magnitude, the behaviours they drive, and consumer attitudes towards them – are not based on fact.

We remain committed to the idea that consumers should be able to choose how they access and pay for advice, and advisers should be able to choose how they charge for it.

Advisers should be able to be fairly remunerated for the cost of providing advice, at the time they provide it.

We believe banning life insurance commissions would put quality cover and expert advice beyond the reach of many Australians. This would drive a significant increase in both underinsurance and misinsurance, with a multi billion dollar adverse impact to the economy.

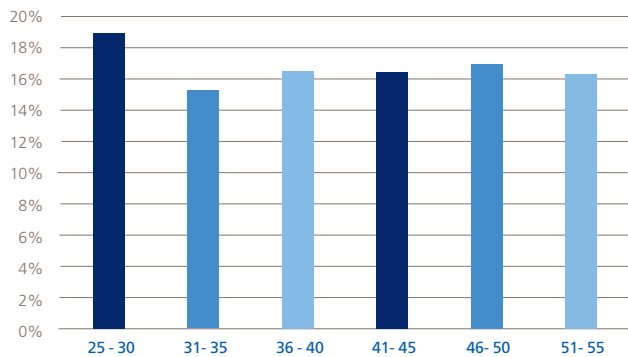
There would also be a significant impact on the supply of life insurance advice, affecting the viability of many advice practices. Significant job losses in the sector would be likely.

# Appendix One

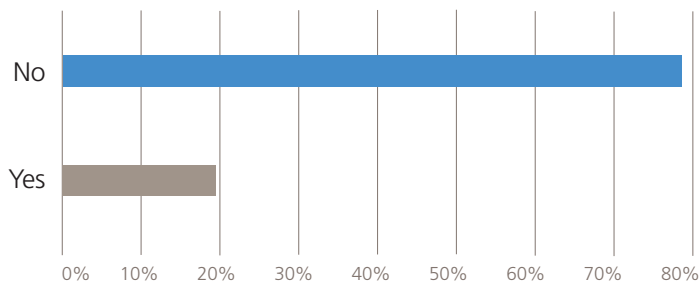
## Consumer Survey Data

The survey was facilitated by Lightspeed Research and focused on consumers broadly representing the target market for life insurance advice, being Australians aged 25 to 55 with combined household income between \$80,000 and \$500,000. An important element of the survey was to ensure that it included participants who had recent experience with financial advice, those that did not but had still purchased life insurance and participants that had not recently purchased life insurance. Over 1,000 individual responses were obtained.

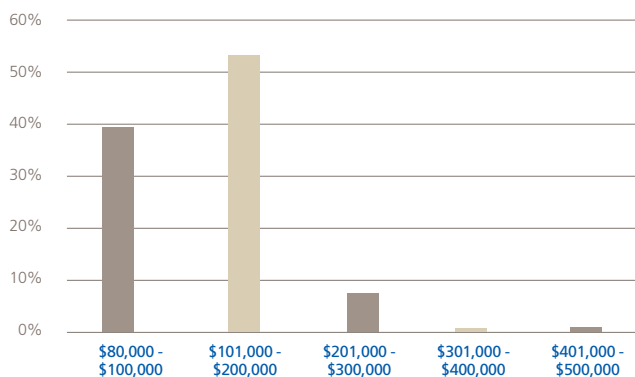
**Figure 18**  
Age



**Figure 20**  
Financial adviser relationship



**Figure 19**  
Household income



# Appendix 2

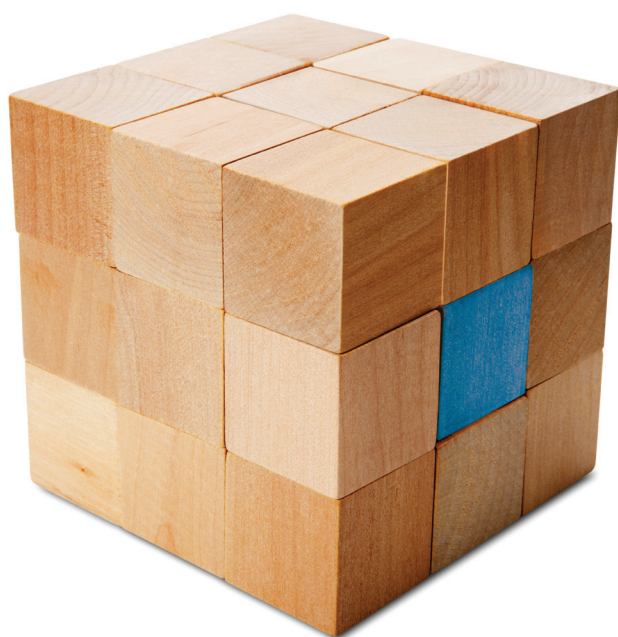
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*Figures 3, 4, 5, 7-12, 14-17:*  
*Impact of banning commissions on Life Insurance policies:* Rice Warner, 2018.

*Figure 6:*  
Zurich Insurance Group, 2018

*Figure 13:*  
*Zurich response to Round 6 policy questions;*  
Royal Commission into Misconduct in the superannuation and financial services industry October 2018.



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