Level commissions for risk advice may not solve the sector's woes

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A mandated level commission remuneration structure for life insurance advisers, as recommended by the Financial System Inquiry (FSI) final report, would be a step too far, according to the head of a risk-focused financial advice practice.

"I don't think level premium is the ultimate answer, because it makes providing advice to a range of clients potentially unaffordable, because the adviser would need to potentially charge fees on top of the premium," says Mark Everingham, managing director, Personal Risk Professionals.

"Larger upfront than ongoing trails might encourage churn, but I think it's the majority of financial advisers being penalised for the actions of a few," he says.

The FSI report, which was handed down last week, recommends a level commission structure implemented through legislation. This would require an upfront commission that is no higher than the ongoing commission.

This mirrored the findings of a report the Australian Securities and Investment Commission (ASIC) presented in October. This found high upfront commissions were more strongly correlated with non-compliant advice, including in situations where the recommendation is to switch products.

"I think the recommendation just requires further investigation on how it would impact consumers. At the same time, I think an upfront model is too excessive, so I think a balance needs to be struck in the middle, like a hybrid structure," Everingham says.

What worries your clients most about investing in emerging markets?

Upfront commission structures, the dominant remuneration method for the provision of life insurance advice, mean advisers receive between 100 and 130 per cent of the total annual premium upfront.

Everingham explains a level commission structure generally means the adviser will receive 20 per cent of the total annual premium upfront, with this percentage figure continuing for the life of the policy.

He believes a hybrid structure is a workable compromise balancing the initial work and costs involved in establishing a policy along with the ongoing effort.

"My business operates on a hybrid commission structure now, we've done that since we started, so for me personally, losing upfront is not an impact. But going all the way to level, for a portion of our clients, it wouldn't cover our time costs or our risk costs of providing that advice to the client."

Personal Risk Professionals' advisers receive 70 per cent of the total annual premium as a commission, with ongoing remuneration of 20 per cent of the annual premium.

While his customer base doesn't generally include this demographic, Everingham says that life insurance advisers servicing "mum and dad style clients" would need to add costs on top if adopting level commissions.

Life insurance is labour intensive

"In all my time, I haven't come across many who [provide life insurance] for under $4,000 cost per client, and that's with all things going smoothly," says Tom Reddacliff, of Reddacliff Consulting. He also worked in NAB's wealth management business MLC for around a decade.

He refers to the example of a husband and wife taking out a combined $2-3 million in insurance through term life and critical illness policies, where they could expect to pay aggregate premiums of around $4,000.

"So if you factor on getting $1200 commission upfront on $4000 worth of premium, you'd have to charge a fee of another 2000 to 3000 to break even upfront.

"It's a very high cost base area of advice, but I think it's wide open for innovation.

I'm a supporter of fees for insurance and level commissions, but you can't just do that in isolation," Reddacliff says.

He suggests a period of substantial change lies ahead for the life insurance sector, with one of two things likely to happen: advisers add a flat fee on top of the upfront commission to cover their costs, or the industry undergoes a dramatic shift.

The first option brings into play the value of advice in insurance, "and you really have to be good at estate planning, to justify charging a discreet fee on top."

In the second option, "something really big happens in the marketplace, and all of a sudden there's substantial cost base innovation which changes the whole economics of life insurance," Reddacliff says.

"This will create tensions and pressure in the system, which will in turn drive the innovation…I think there's going to be enormous ruction in the insurance environment."

This is likely to be driven by technological developments reducing the costs of providing insurance advice, such as innovative approaches to underwriting.

But in the shorter term, Reddacliff suggests the introduction of mandatory hybrid commissions for insurance advisers appears likely.
