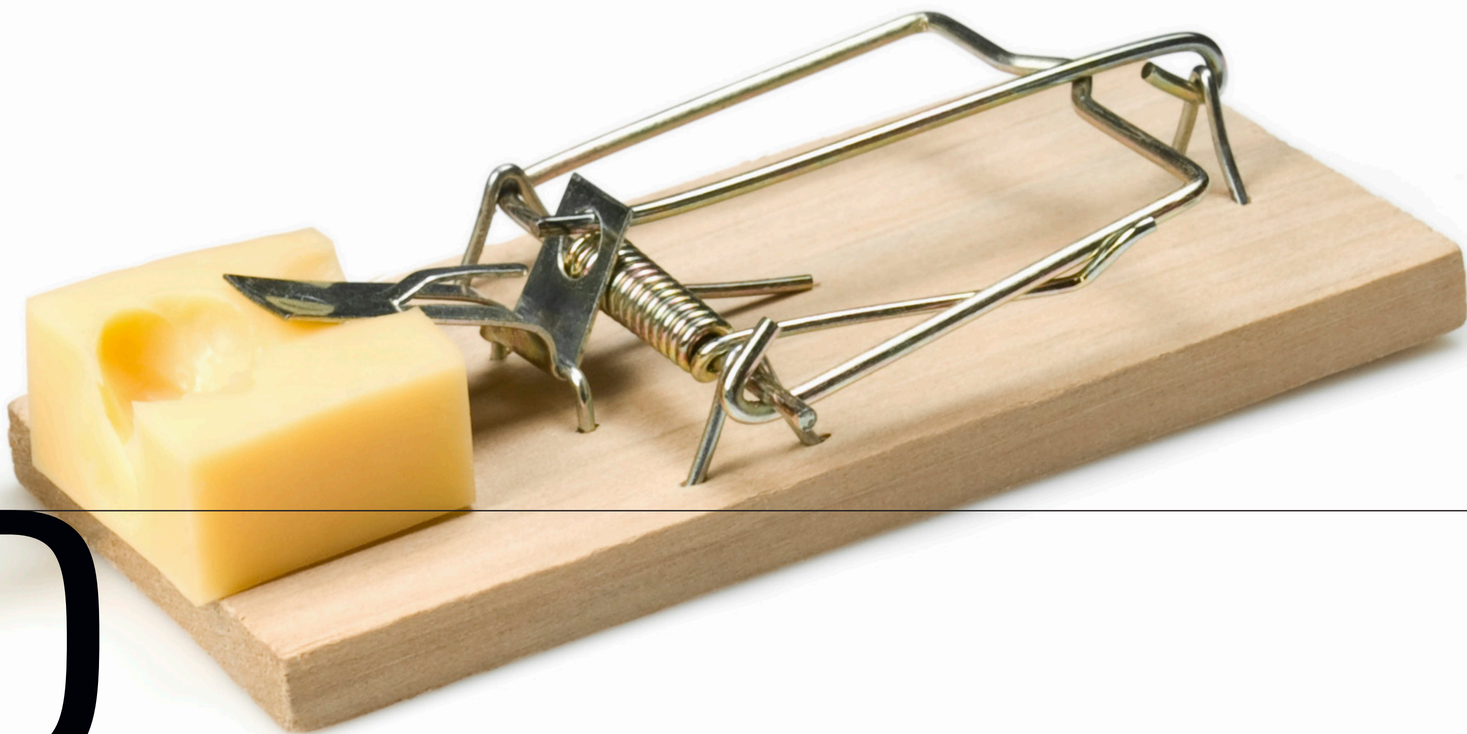
RISK & REWAR

IT'S A FINE LINE BETWEEN RUNNING A LUCRATIVE LIFE INSURANCE BUSINESS AND SPRINGING A REGULATORY TRAP

GLENN FREEMAN REPORTS



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The government's Financial System Inquiry (FSI) has gone some way to clearing the bottleneck of vested interests and suggested solutions around fixing Australia's life insurance industry.

The FSI interim report was released in July, with the final report due in November. The inquiry's broad scope includes Australia's life insurance industry, with the issue of underinsurance frequently addressed in industry submissions.

According to the interim report: "Some submissions put forward the view that underinsurance for life and disability is significant, requiring policy measures to close the 'underinsurance gap'.

"Rice Warner estimates that current life insurance cover is 64 per cent of the amount needed, with disability insurance much lower again."

In its submission, the Financial Services Council (FSC) refers to a KPMG study showing that 35 per cent of employed Australians have no private disability insurance. And it estimates that the aggregate level of underinsurance – that is, the desired level of disability insurance, less the actual level – is about $305 billion per annum.

Along with its analysis of stand-alone life insurance, the FSI also examined the underinsurance problem through its analysis of the superannuation sector and of financial adviser competence. This includes issues around education standards, the planned public register of advisers, and proposed enhancements to the regulator's powers.

Chan & Naylor, an accounting and financial planning firm licensed by non-aligned group Patron Financial Advice, has issued both first- and second-round submissions to the FSI. It raises concerns about specialised life insurance financial planning, suggesting "the insurance sector has been allowed to morph itself into the financial advice profession".

David Hasib, Chan & Naylor partner and senior wealth adviser, believes there should be a clear distinction between financial planners who focus on risk and those who provide advice spanning the full range of investments, superannuation and retirement planning.

He suggests that out of "16,000-odd planners, a good two-thirds is made up of individuals who are risk specialists, but yet they're called financial advisers".

"I think it's a bit confusing for the consumer," Hasib says.

"A consumer who requires financial advice is often confronted by an individual that talks about insurance policies and basic managed funds, [but] hardly [at all] about strategy-based advice, the broader universe of investments and the implications of tax.

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RISK-ONLY ADVICE

Contrasting with Hasib's concerns about risk advisers, others suggest that risk advice is best provided by specialists, rather than those who provide fully scoped financial planning.

Mark Everingham, managing director of Personal Risk Professionals (PRP), a corporate authorised representative of Bombora Advice, says: "It raises a question in my mind around the level of expertise of those people in the financial planning practices providing that advice.

"Part of the reason we are solely risk-focused is that I'm a big believer in specialisation. Risk [advice] in financial planning is a specialised area, as is investment and retirement planning.

"While it may be a growing component of revenue for a practice, is the level of expertise there to deliver it appropriately?" he asks.

Everingham says he encounters a number of financial planning firms that prefer to concentrate on areas such as investment and retirement planning.

"We act for a couple of financial planning firms who say, 'this is an important area of advice for our clients, and we want that to be dealt with by a specialist'," he says.

RISK &

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THE QUESTION THEN ARISES: 'WHAT'S THE BASIS OF THAT? IS IT A NON-DISCLOSURE ISSUE, HAS A POLICY BEEN REPLACED, WHEN [THE CLIENT] WAS BETTER OFF WHERE THEY WERE?' WHENEVER THERE'S A SIGNIFICANT POINT OF LOSS, IT GETS ATTENTION

"There are planners out there using a conduit like us. Personally, I don't know if one person can be across all the intricacies of providing risk advice as well as all the requirements of delivering a high level of financial planning advice on top of it. It's a very broad proposition to deliver."

LIFE INSURANCE AS A RED FLAG TO ASIC

The Australian Securities and Investments Commission (ASIC) was due to hand down a report into "churning" of life insurance policies by the end of September (after *Professional Planner* went to press).

"When we find poor advice in a licensee, more often than not, poor advice around life insurance is a key problem. It's frustrating that that's still the case," ASIC deputy chairman Peter Kell told a Financial Services Council conference in early August.

Kell made similar comments more than a year earlier, referring to "commission-based incentives in remuneration combined with inadequate compliance [that does] not align the interests of the adviser with the client".

This reflects the fact that "churning" – or excessive switching of life insurance policies by advisers – is a long-running issue for the industry, yet to be fully addressed.

The Future of Financial Advice (FoFA) reforms banned the payment of commission-based remuneration for investment advice. However, it remains the most commonly used model within life insurance advice – though some financial planners have adapted fee-for-service structures by dialling down commissions.

Regarding the anticipated ASIC report on life insurance, Everingham believes the claims process also needs to be reviewed, particularly as it relates to disclosure.

"I've heard rumblings of what is potentially coming out [and] whether it's around retirement, advice or claims not being paid… but typically, I think risk becomes very visible when claims aren't being paid," he says.

"The question then arises: 'What's the basis of that? Is it a non-disclosure issue, has a policy been replaced, when [the client] was better off where they were?'

"Whenever there's a significant point of loss, it gets attention."

AN INNOVATION BREAKDOWN

A lack of product innovation in the life insurance space may also be reducing uptake – though the Stronger Super reforms that took effect from July 1 have seen a number of upgrades to "in-super" life insurance offerings.

The FSC's second submission to the FSI draws a link between financial services regulation, diminished product innovation and poor consumer take-up.

It says: "A more effective regulatory framework would allow a better priced and more consumer-focused product offering. This would improve the efficiency and effectiveness of insurance markets in Australia by minimising regulatory compliance costs."

Damien Mu, chief executive officer, AIA Australia, agrees this has had an impact. "The industry has been busy trying to understand all the regulations…and has been a bit busy and introspective," he says.

However, he says AIA has given more focus in recent times to bringing innovation to the market.

"There is a growing awareness and demand from customers in the market, and a need to differentiate and become a little more relevant to people's lives," Mu says.

"I think there's work being done to look at products more in a life-stage process, such as for those in the earlier stages of their life. They may not need a lot of cover. Is there a more simple retail product they can take up, which gives them an entry point?"

In March this year, AIA launched a new customer engagement program, called AIA Vitality. Sold by financial advisers, it is an incentivised health and wellness program that allows eligible insurance clients to earn points that entitle them to various rewards, including reduced risk premiums.

Speaking about the broader product landscape, Mu says: "I think we're seeing a lot of tweaks to definitions, additional coverage to pick up different events. But I think innovation is more about looking at how we develop more life-stage products to meet consumer needs at different times."

INSURANCE BUSINESSES STILL

ATTRACTIVE

Perhaps adding to the attention the sector is drawing from ASIC, and despite the challenges faced by life insurance companies in recent years, risk remains a profitable area for financial planners.

Around 90 per cent of Australia's financial planners provide life insurance advice, which accounts for just under a third (29 per cent) of practices' overall revenue, according to an Investment Trends survey released last month.

The 2014 Planner Risk Report, which surveyed around 900 planners, found that respondents expect risk advice to contribute even more to profits over the next few years, reaching 31 per cent by 2017.

"Risk continues to be a key component of many planners' businesses," says Investment Trends senior analyst Recep Peker.

He believes insurance companies can further stimulate financial planning firms' interest in risk business by addressing key challenges, "chiefly high premiums, administration issues and inefficient processes".

John Birt, principal of Radar Results, a consultant and broker of financial planning businesses, backs these findings.

However, he first makes the point that the provision of risk advice is not only a lucrative pursuit, but is part of the bedrock of providing holistic, professional financial planning.

"It's paramount that [planners] offer life insurance to their clients," Birt says. "It's not just a revenue stream…client-wise, in doing the right thing by the client, if you're not looking at clients' insurance needs, you're being negligent I'd say. Even outsourcing it is a bit silly."

Birt says Radar receives about five times more inquiries from prospective buyers of financial planning businesses that also incorporate risk advice, than from those looking to acquire purely investment-led practices.

"You can actually earn a lot of money in life insurance sales…we've got a client in Queensland who generates $1 million in upfront revenue annually," he says.

"You tend to get a lot more for your life insurance recurring revenue business than your investment [advice business] – probably 25 to 30 per cent more if you're selling the business."

A key reason for this is the commission-driven remuneration structure of life insurance versus the increasingly popular fee-for-service model in the financial planning profession.

Birt says another benefit of a risk business is that revenue is not linked to sharemarket performance. So during market downturns, it provides a buffer against reduced revenue from investment-based advice.

"Also, you don't have to do a lot of tax planning, imputation calculations, et cetera; [there are less] intricate financial planning aspects, it's pretty straightforward," Birt says.

"I believe [risk practices] will be the most sought-after types of business over the next few years."

While ageing population demographics are having a distinct impact on the broader life insurance sector – in particular, through higher claim rates - they also play into the hands of brokers such as Birt.

He says many risk-focused businesses are owned by principals from the "baby boomer" generation, who "tend to be older, in their 60s or 70s now".

"Many of them were life insurance agents in the 1980s and 1990s, with a pretty good chunk of risk business [that they're] looking to sell," Birt says.

"That's who we're after; there's plenty of demand from our clients to buy them.

"The main thing is, it's access to new clients. A good planner can jump in there with a team, write a lot of business on it…[you can] make a lot of money, plus help the client."

And helping the client is an area where there is often plenty of room for improvement.

"Also, older life insurance businesses tend to have not looked after their clients too much," Birt says.

He refers to something of a "set and forget" mentality among some risk advisers, who are content to leave a policy in force, with little additional advice for an extended period, while continuing to benefit from the flow of commissions.

Meanwhile, it is the "over-servicing" of clients by some other risk advisers – via "churning" – that continues to ring alarm bells for ASIC. P