

“Regulating Life Insurance Sales – Some Personal Thoughts”

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Disclaimer

1. This is not a presentation on the “MJW Report”.
2. Originally it was going to be but it is not – hence the new title.
3. Anything I say is my opinion and mine alone.
4. My view may differ from my employer’s and everyone else’s.
5. If there are any press present, anything I say is off the record and not to be reported. Thank you.

Thought for the day – global theme

- “Caveat Emptor” to “Caveat Venditor”
 - “Let the buyer beware” is being replaced by “Let the seller beware”
- Is this part of economic efficiency / progress?

Worldwide Trends

- Predates GFC – there are earlier “scandals”: Pensions etc
- But the GFC has really stimulated activity
- Inappropriate financial incentives are being blamed for everything
 - “Banksters”
- Regulators thinking about financial incentives and their impacts
- The pendulum is swinging back against “performance pay”
- How far does this go?

USA

- All the way to the President of the United States!
- Executive Office of the President of the United States
 - Council of Economic Advisers “THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS” in February 2015
*“Investment losses due to conflicted advice result from the incentives conflicted payments generate for financial advisers **to steer savers into products or investment strategies that provide larger payments to the adviser** but are not necessarily the best choice for the saver.”*

- Consumers International - is the world federation of consumer rights groups – October 2014:

“Inappropriate sales incentives schemes employed by retail banks are an underappreciated and undermanaged risk to financial consumers and financial stability. This is the headline conclusion of our unique look at the continuing lack of adequate consumer protection in financial services.

Drawing on evidence from consumer organisations, trade unions, banks and regulators in G20 nations and some OECD countries, “*Risky business: The case for reform of sales incentives schemes in banks*”, demonstrates the pain and despair suffered by individuals who have been persuaded to buy inappropriate financial products, as well as the threat that these schemes pose to financial stability.”

UK cont...

- That talks of investments and banks but insurance is often intertwined
- PPI – £21.1b paid to date and still counting – unprecedented
- Plevin UK Supreme Court November 2014 added fuel to the fire:
 - The commission was so high (71.8%), although not required to be disclosed, it was unfair not to do so under 1974 Consumer Credit Act
- Financial Conduct Authority consulting on what to do:
 - The proposed rules and guidance would say that a firm should presume, when assessing a relevant complaint in respect of a PPI policy covering a credit agreement under s.140A, that a failure to disclose a commission of 50% or more gave rise to an unfair relationship under s.140A.

UK cont...

- PPI driving a lot of thinking in the UK:
 - publish loss ratios on your website?
- FCA apparently examining the practice of exploiting loyal customers
- FCA relying on insights from behavioural economics to justify regulating
 - Customers cannot be relied upon to act rationally so we need to intervene

Australia

- **FOFA (Future of Financial Advice reforms)**
 - Banning of commission considered (banned on group life from super)
 - Industry Super Australia argues for a wider ban
- **ASIC**
 - “Review of retail life insurance advice” - 96% of the cases which failed the advice test were sourced from up front commission policies
- **Trowbridge**
 - 80% year 1 and 20% ongoing
- **FSI**
 - Level commission

Australia cont...

- Australian Government announcement – will legislate for ASIC to implement through a legislative instrument from 1 July 2016:
 - A transition to a commission cap of 60% yr 1 and 20% thereafter from 1 July 2018 with a 2 yr clawback
 - A ban on volume based payments
 - A life insurance code of practice and expanded APLs
 - Report replacement policy data to ASIC
 - A review in 2018 and legislate to facilitate rationalisation of legacy products
- So Australia taking the step to regulate life insurance commission but will there be more ...

Australia cont...

- **APRA:**

Mr Laughlin identified poor practices such as product features added at no cost or with little analysis of impact, disablement and trauma definitions that are open to interpretation or obsolescence and basic problems with underwriting and claims management.

“The advent of questionable practices often has been driven by the desire to score well in product ratings, by ratings houses, **in a bid to attract business from advisers,**” he said.

- **ASIC:**

"That when an employee breaches a law ASIC administers [and] the culture is responsible, then not just the employee ... but also the officers and the company should be held responsible."

- What is the relevance of all this for NZ?
- Conflicts of interest in the advice process for financial services
 - these are going to be examined at some point: 100% certainty
- “The FMA’s Strategic Risk Outlook 2015”
 - “Remuneration and incentive arrangements can also reinforce conflicts of interest, particularly when sales staff are remunerated on a volume basis or through certain bonus structures”
 - “These remuneration arrangements may include certain volume-based incentives, up-front commissions and trail commissions”
 - “Mis-selling of insurance products ...”

- **FAAR Issues Paper:**

- **Hon Paul Goldsmith:**

“Global practice has shifted since 2008. A number of countries have moved beyond insisting on transparency over commissions to an outright ban on commissions for financial advisers” and

“guarantee that conflicts of interest are effectively dealt with”

- **Q41:**

“Do you think that commissions should be restricted or banned in relation to financial advice, and if so, in what way? What would be the costs and benefits of such an approach?”

NZ cont...

- So “conflicts of interest” in relation to life insurance sales (or conflicted remuneration) is on the radar
- s25 request – investigation into adviser behaviour not insurers
 - FMA are not the market conduct regulator of insurers
- Where is the conflict of interest in relation to insurance?
 - Fee for service vs commission
 - A way of describing a conflict of interest is a position where you can exploit the situation for your own self-interest. An adviser can act in their own best interests in preference to that of the customer and benefit financially.

NZ cont ...

[YouTube clip](#)

- Interesting on two levels:
 1. Life insurance is something to make fun of
 2. Marge wants to buy it – if only that were true for all people
- Evidence is life insurance has to be sold so we have to accept the payment of commission and the conflict of interest that comes with that.

NZ cont ...

- Where do the material conflicts arise? Trowbridge initial commission.
- What should NZ do? Australia is addressing the issue. One of the objectives of the FAAR review is harmony with the Australian regime
- Do we believe disclosure works? How could we make disclosure more effective? Verbal disclosure?
- If reports of 50% of new business is replacement are true how do we ensure those replacement policies are in policyholder interests?
- We've tried regulating advice – should we just regulate product?
- Globally life insurance has remained intertwined with superannuation – is this a way to expand life insurance penetration?