



# Life Commission Reforms

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# Agenda

- **Where are we now?**
  - Overview of changes
  - Anticipated impacts
  - Risks and unknowns
- **Actuarial implications**
  - Assumption setting – industry view
  - Potential lapse rate outcomes
  - Drivers of lapse experience
  - Challenges in analysing experience
- **Where to next?**
  - International movement
  - Future intervention





# Where are we now?

## Overview of changes

### Life Insurance Framework (LIF)

The framework will apply to sales made under both personal advice (via financial advisers) and general advice (via direct distribution).

#### Remuneration model

- Maximum first year commission of 80% (excl. GST) from 1 July 2016.
  - The cap reduces to 70% from 1 July 2017.
  - The cap reduces to 60% from 1 July 2018.
- Maximum ongoing commission of 20% from 1 July 2016.
- Two year retention ('clawback') period from 1 July 2016.
  - 100% clawback in year 1
  - 60% clawback in year 2
- Ban on other volume-based payments from 1 July 2016, with appropriate grandfathering arrangements, consistent with FoFA.

#### Other measures

- FSC to develop a Life Insurance Code of Conduct.
- FSC to develop an industry standard regarding widening of Approved Product Lists (APLs).
- ASIC to review Statements of Advice to make disclosure simpler – and also consider measures to strengthen disclosure of remuneration.

# Where are we now?

## Anticipated impacts

### Insurers

### Advisers

#### Short term implications

- Impetus to support **productivity improvements**
- Need to **review distribution agreements** and outsourced telemarketing arrangements
- **Process changes** required to comply with new framework
- Consideration of **repricing and premium guarantees**

- Forced to **adapt business models** due to cashflow impacts, e.g.:
  - Using **technology** to perform parts of the advice process
  - Building a value proposition to support a **supplementary fee-for-advice**

#### Longer term implications

- Improved life insurer **return on capital**
- Impetus to consider **diversifying distribution channels**
- Partially **mitigate** the additional **new business P&L strain** under the forthcoming accounting standards (IFRS 4)

- Providing life insurance advice may become **less attractive for new entrants**
- Some independent advisers may join institutionally-owned financial advice groups or leave the industry

Customer?

# Where are we now?

## Risks and unknowns

Risk / unknown	Description
<b>Approved Product Lists (APLs)</b>	<p>Unclear as to the timing and level of prescription with any FSC industry standard.</p> <p>Potential impacts:</p> <ul style="list-style-type: none"> <li>- The value of institutionally-owned distribution will reduce if APL's are forced to widen.</li> <li>- Change will favour those insurers who already compete primarily through the IFA market.</li> </ul>
<b>Grandfathering</b>	<p>Commissions and volume based payments made under pre-existing arrangements in relating to pre-existing policies will be grandfathered.</p> <p>Can the provisions still be used by insurers to subsidise the fall in first year commissions, undermining the LIF objectives?</p>
<b>ASIC review</b>	<p>ASIC has been asked by Government to review the effectiveness of the Life Insurance Framework in 2018, with the potential for further reform.</p>



# Actuarial implications

## Assumption setting – industry view

Expected change in lapse experience  
over the **next year**

Increase

Stable

Reduction

Proposed adjustment to lapse  
assumptions

No  
adjustment

High level  
adjustment

Detailed  
adjustment

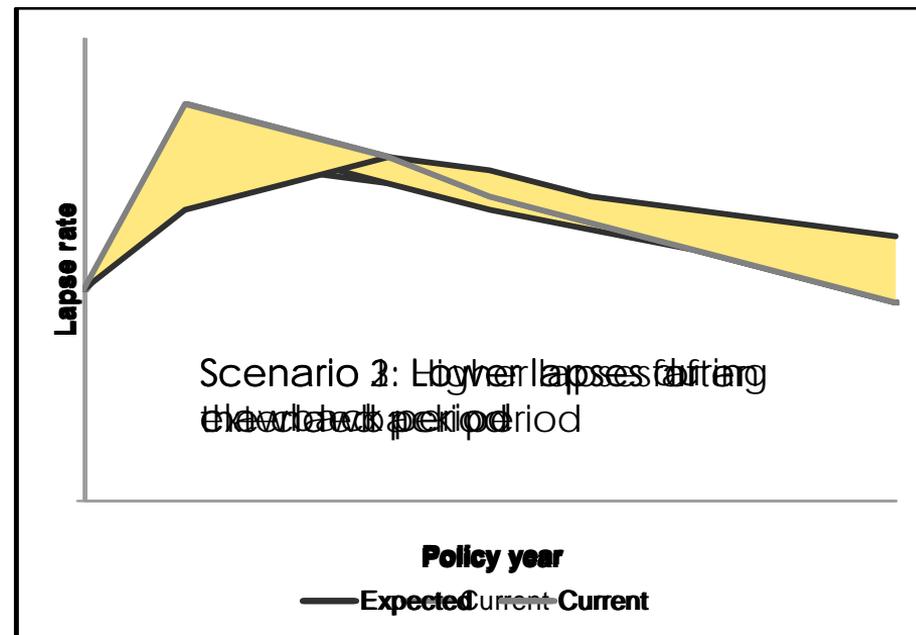
What is driving the uncertainty?



# Actuarial implications

## Potential lapse rate outcomes

- Shape of lapse experience is likely to change
- Advisor impacts
- Customer impacts
- Profitability implications and opportunities





# Actuarial implications

## Drivers of lapse experience

- Insurers use a variety of factors to set lapse assumptions
- What factors drive the incentive to churn?
- Shape of experience likely to change
- Multiplicative factors may require rebasing

Factor
Policy duration
Age
Premium structure
Commission structure
Distribution structure
Gender
Sum insured
Smoker status
Premium frequency



# Actuarial implications

## Challenges with analysing experience

- Identifying data fields for extract
- Judgement vs data driven approach
- Length of investigation period
- Multi-dimensional and multi-period analysis

Financial year ending	2016	110/10	110/10	110/10	110/10
	2017	80/20	110/10	110/10	110/10
	2018	70/20	80/20	110/10	110/10
	2019	60/20	70/20	80/20	110/10
			1	2	3
		Policy duration			



# Actuarial implications

## Summary

### Observations and expectations

- Uncertainty about impact
- Some benefit expected to have already occurred
- Wait and see attitude among the industry
- Some challenges in analysing experience

### Opportunities

- Revisit and restructure experience studies in advance
- Consider using more judgement in setting assumptions
- Consider future regulatory changes
- Avoid lagging experience



# Where to next?

## International examples

<b>South Africa</b>	Currently has commission caps: <b>85%</b> of first year premium, and a % of the expected total premiums over fixed term policies (where applicable)
	<p><u>2014 Retail Distribution Review proposals included:</u></p> <ul style="list-style-type: none"> <li>a) Reduction of current upfront commission caps to <b>50%</b> of total remuneration payable (the remainder being 'ongoing servicing fees' – also capped), and</li> <li>b) Prohibition of commission on replacement policies (i.e. advice fees only)</li> </ul>
	<p><u>December 2015 status update:</u></p> <ul style="list-style-type: none"> <li>a) Commission caps: further impact testing (2018 timeline for final implementation)</li> <li>b) Prohibition of commission on replacement policies: monitoring obligations on insurers from July 2016, followed by more specific remuneration interventions</li> </ul>
<b>Singapore</b>	Similar commission caps are expected to be implemented from 1 January 2017. (i.e. 55% of remuneration in the first year and 45% over the following 5 years).

### Sources:

#### South Africa:

Long-term Insurance Act 1998: [http://www.saflii.org/za/legis/consol\\_act/lia1998212/](http://www.saflii.org/za/legis/consol_act/lia1998212/)

Financial Services Board – Retail Distribution Review, Consultation Paper November 2014: <https://www.fsb.co.za/NewsLibrary/FSB%20Retail%20Distribution%20Review%202014.pdf>

Financial Services Board – Retail Distribution Review, Phase 1 Status Update December 2015: <https://www.fsb.co.za/NewsLibrary/FSB%20Retail%20Distribution%20Review%20Phase%201%20Status%20Update%202015.pdf>

#### Singapore:

Monetary Authority of Singapore: <http://www.mas.gov.sg/News-and-Publications/Consultation-Paper/2014/Consultation-Paper-on-Draft-Legislation-and-Legislative-Amendments-for-FAIR-and-Inspections-by-FRAs.aspx>

International Adviser ("Life industry responds to Singapore commission cap delay", 26 November 2015): <http://www.international-adviser.com/news/1026148/life-industry-responds-singapore-commission-cap-delay>



# Where to next?

## Future intervention

*“Labor does support the passage of this legislation that will make incremental improvement to the life insurance remuneration structures.”*

Shadow Minister for Financial Services and Superannuation, Jim Chalmers (RiskInfo, 8 March 2016)

- **Change of Government ???**

- LIF legislation currently sits in limbo – with an election looming.
- The Labor position was to support the passage of the LIF legislation as a step in their desired direction, but they may also look towards further reforms.
- Insurers are set to implement changes in systems from 1 July 2016 as required

# Where to next?

## Future intervention

Goals of ASIC review: *“establish whether the life insurance reforms have been effective in producing better outcomes for consumers”* – ASIC Consultation Paper 245

- **ASIC has been asked by Government to review the effectiveness of the Life Insurance Framework in 2018.**
  - ASIC intend to collect data from insurers over 2017 and 2018 to inform their review, covering:
    - Lapse rates and clawbacks
    - Adviser remuneration
    - Distribution profile
    - Portfolio profile
  - ASIC intend to work with industry regarding data availability before issuing the formal data request.



# Where to next?

## Future intervention

*"If the 2018 review does not identify **significant improvement**, the Government will move to mandate level commissions, as was recommended by the Murray Inquiry."*  
Press Release from Assistant Treasurer Kelly O'Dwyer (6 November 2015)

- **Challenges in showing 'significant improvement' in outcomes for customers:**
  - What does success look like?
  - No agreed definition of 'churn' or means to measure it
  - Limitations of available data – what is measurable may not be relevant, and what is relevant may not be measurable!
  - Timeframe of the review (during 2018):
    - Transition to final state will not be complete
    - Policies sold on new commission structures still within clawback period
    - Recent improvement in lapse rates – prior to 1 July 2016

# Questions?

