FINANCIAL ADVICE ASSOCIATION AUSTRALIA

General Manager, Macro and Industry Insights
Australian Prudential Regulation Authority

Via Email: dataconsultations@apra.gov.au

22 December 2023

Dear APRA,

Life Insurance Discussion Paper – Insurance Data Transformation

The Financial Advice Association of Australia[1] (FAAA) appreciates the opportunity to provide feedback on APRA's consultation on Life Insurance Data Transformation.

Financial Advisers are an important stakeholder in the life insurance industry, playing a critical role in the placement of life insurance (over 50% of in-force life insurance premiums). Life insurance is a complex product, that few Australians sufficiently understand, necessitating the provision of financial advice to assist clients in making these important decisions. Often, in the absence of financial advice, Australians do not understand what cover they need and will typically end up substantially underinsured. The average level of death cover in Group Super schemes is approximately $220,000, whereas the average mortgage in Australia is over $500,000. This level of cover is well below what is required. One of the generally accepted concepts with life insurance is that as a minimum, the level of cover should enable the repayment of any outstanding debt by the surviving spouse.

In this submission, we have largely limited our feedback to the area of financial advice related to life insurance, and have not looked more broadly at the Insurance Data Transformation. We do however support the intent of the collection of granular data to assist in the oversight of prudential and conduct risk. We have focussed in this submission on the challenges faced by the life insurance industry over the last few years and have identified a range of factors that we believe

[1] The Financial Advice Association of Australia (FAAA) was formed in April 2023, out of a merger of the Financial Planning Association of Australia Limited (FPA) and the Association of Financial Advisers Limited (AFA), two of Australia's largest and longest-standing associations of financial planners and advisers.

The FPA was a professional association formed in 1992 as a merger between The Australian Society of Investment and Financial Advisers and the International Association of Financial Planning. In 1999 the CFP Professional Education Program was launched. As Australia's largest professional association for financial planners, the FPA represented the interests of the public and (leading into the merger) over 10,000 members. Since its formation, the FPA worked towards changing the face of financial planning, from an industry to a profession that earned consumer confidence and trust, and advocated that better financial advice would positively influence the financial wellbeing of all Australians.

The AFA was a professional association for financial advisers that dated back to 1946 (existing in various forms and under various names). The AFA was a national membership entity that operated in each state of Australia and across the full spectrum of advice types. The AFA had a long history of advocating for the best interests of financial advisers and their clients, through working with the government, regulators and other stakeholders. The AFA had a long legacy of operating in the life insurance sector, however substantially broadened its member base over a number of decades. The AFA had a strong focus on promoting the value of advice and recognising award winning advisers over many years. The AFA had strong foundations in believing in advocacy for members and creating events and other opportunities to enable members to grow and share best practice.

need to be closely monitored, including new business volumes, discounting practices, premium increases, average policyholder age, discontinuances, underwriting and leakage of benefit payments.

Background

The life insurance industry and the life insurance advice sector have been subject to substantial change over recent years, including with respect to the following:

- The exit of the large banks and other financial institution owners.
- The introduction of the Life Insurance Framework (LIF) and the establishment of caps that have reduced commissions and extended clawback arrangements.
- The Protecting Your Super Package and Putting Members Interest First Package, which have both resulted in a number of Australians being removed from life insurance pools and additional barriers introduced to obtaining cover when commencing super.
- Professional standards reforms for financial advisers, including the requirement to pass an exam and achieve a degree equivalent education standard.
- The APRA intervention into the Individual Disability Income Insurance (IDII) market.
- Increasing claims, particularly related to mental health issues.
- Despite all the focus on the continuation of the payment of commissions for life insurance advice, they remain the dominant form of remuneration and even when advisers offer their clients a choice between fees or commissions, the client invariably chooses to pay for their advice through a commission.

The consequences of all of these reforms and structural changes have been broad, however the direct consequences for advised life insurance have been significant, as follows:

- A substantial reduction in the number of financial advisers providing life insurance advice. This is often stated to be at a rate much greater than the 45% overall reduction in adviser numbers since 1 January 2019.
- The exit of advisers from this segment of the market is attributable to the reduction in commissions (LIF), professional standards reforms, increasing compliance obligations and demands of staying up to date with product changes (the IDII reforms resulted in a complete change of the products offered across all life insurers).
- A reduction in life insurance new business volumes of greater than 50% over the last five to seven years. Given increasing premiums, the reduction in new policyholders is expected to be much greater than 50%
- The reduction in new business has created an increase in price competition with the emergence of sub-optimal practices such as upfront discounting, where a discount applies for the first year or the first few years, which is then quickly removed/reversed. The consequences of this is that premiums rise more rapidly than they otherwise would, which

generates great levels of client dissatisfaction and discontinuance in the second and third years.

- Due to reduced commissions and the increased cost of providing life insurance advice, financial advisers are focussing more on higher premium clients. This means that younger Australians, who would expect to pay lower premiums, are typically not the focus of advisers and will struggle to get advice on life insurance. New clients are now typically older and more highly paid, which has substantially changed who the new clients are who are going into the risk pools.
- Significant premium increases across all product types, however particularly with the IDII product. The consequence of this is that financial advisers are spending substantially more time on the retention of existing clients who are often seeking solutions to address the consequence of large premium increases and the challenge with affordability.
- Significant challenges for Level Premium products, where premium increases have been substantial and often at a greater rate than Stepped Premium products. As a result, this has undermined the long term title of “level” for these products.

In short, it is easy to conclude that the advised life insurance sector is in crisis. This is only part of the story, as the flow on consequences for life insurance are equally important, with fewer new entrants into the life insurance pools and particularly in terms of younger lives. This will undoubtedly over time push up the average age of insured Australians, which will fundamentally change the economics of the life insurance business model.

Implications for Data Collection

In the context of the challenges that the changes in the environment and regulations have caused, we believe that it is essential that data collection focus on some of these key factors that provide an insight into the sustainability of the life insurance industry and the trends in the marketplace. We would suggest that the following key factors should be considered in defining the future data model:

- Genuine new business volumes and new policy holder numbers. The focus should be on new clients into new policies, rather than increases to existing policies. The ongoing practice of indexing the level of cover each year, and treating this as new business, can distort the real underlying level of new business. In some cases, the rate of indexing has been much more than CPI.
- The extent of underlying upfront premium discounting, possibly measured in terms of dollars of premiums that have been discounted, relative to standard pricing.
- The extent of premium increases measured in terms of the percentage change in standard rates and the aggregate impact on total in-force premiums.
- Average age of clients. This is a good marker to measure the level of risk in the insurance pool and the extent to which the risk pools are being refreshed with younger lives.

- Lapses or discontinuations, split between those that are partial in order to address affordability challenges, where the client is determined to maintain some level of cover, and complete lapses, where the cover is either no longer needed or the client has elected to discontinue. We would like to see the availability of data on the reasons for discontinuation. We propose the establishment of some additional standard discontinuance categories such as moved to more competitive offering, no longer required, unaffordable, etc. Discontinuances should be measured in terms of total dollars of premiums and number of policyholders.
- Underwriting data, including the level of applications that are rejected outright or subject to exclusions or loadings. Underwriting is an important control, but also a good indicator of the level of competition in the new business marketplace.
- Life insurance is ultimately about getting benefits to those policyholders (or their families) who have suffered a major injury or illness. A measure of this is the percentage of premiums that end up in the hands of claimants. There can be natural leakage from this system through the costs experienced along the value chain, some of which are well understood, however others are largely unknown. Financial advisers largely do not charge for the management of claims, unless the claim is particularly complex. There are other stakeholders who do play a role to assist claimants, and can charge a significant amount for this service. We would support the collection of data on what percentage of the benefit is paid to a third party when a third party is involved.

In the context of recent media coverage about unreasonable delays in the payment of death benefits by super funds, we would suggest that tracking the average time to pay a claim would be a useful metric.

Recommendations

We recommend that APRA consider our proposals above in terms of the collection of additional data. We would like to see this data made publicly available.

We do want to make the point that we are very aware of the cost involved in the collection of this data, and that what is mandated for collection needs to be able to be efficiently collected. Otherwise, it is not likely to deliver the macro level value that we are seeking and will ultimately result in consumers paying more for their life insurance.

Conclusion

We welcome the opportunity to provide APRA with feedback on the Insurance Data Transformation.

We have set out some key considerations that have influenced the life insurance industry in recent years and the broader consequences for the advised life insurance sector to set the scene on our views of the challenges faced by the industry. We have done this in order to seek to put a spotlight on what industry data needs to be observed to ensure the ongoing health of the life insurance industry.

The FAAA would welcome the opportunity to discuss the issues raised in our submission in more detail. Please contact me on 02 9220 4500 should you have any questions.

Yours sincerely,

Phil Anderson
General Manager Policy, Advocacy & Standards
Financial Advice Association of Australia