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APPENDIX ONE

The Importance of Product Choice – Life Insurance

There has been significant conversation about the differences between and merits of AFAs, RFAs and QFEs.

We acknowledge that if a consumer is simply being sold a product, are not being advised on whether the product is to meet any specific needs they might have, and are not in any way provided with opinion about the comparative value of the product versus any existing product or any competitive product, then advice is not being provided.

Where advice is being provided, each of these categories of advisers will generally follow a six step financial advice process (involving fact finding, needs analysis, the development of recommendations etc) and each is required to demonstrate that they have put the client's needs first.

So while each adviser/QFE will have its own unique six-step process, they are each effectively doing the same job for the client in terms of identifying risk protection needs, and the amounts and types of cover required.

Where the job does differ is in whether the adviser is then able to offer the client product choice or not, in order to identify the closest match between the client's best interests and the recommended product. Of course, it is possible that even if an adviser can only represent one product provider, that product could deliver the best match for the client, however this cannot actually be verified if the adviser is unable to accurately analyse other products.

There can be significant differences in the coverage provided at point of claim between product providers. The wide gap between the product ratings determined by the independent research houses is evidence of this. This is the reason why product choice is of significant value to consumers.

Again whether an adviser is an AFA, RFA or belongs to a QFE does not necessarily determine their ability to offer the client choice.

Some AFAs/RFAs are limited in their ability to offer choice as a result of product quotas they are contractually obligated to meet, while some QFEs include a range of product providers in the panel of products their advisers are permitted to write meaning their advisers can offer choice. At present, it is probable that the majority of QFE advisers would have very limited, if any, access to life insurance products outside of those manufactured by their own QFE parent.

Independent QFEs, AFAs and RFAs, can choose which product providers they wish to have agency agreements with. This choice might be based on: providing their customers with access to the entire range of the different types of products available; product providers with the highest rated products or the cheapest prices; product providers based on a minimum credit rating; the value the adviser perceives in each product provider's claims paying philosophies; the amount of adviser remuneration on offer; or that the advisers only hold agency agreements with the providers whom would actually grant them (or allow them to retain) an agency agreement.

In the case of QFEs (who do offer a panel of approved product providers), there may still effectively be an element of control over where an adviser chooses to place their business by having differing remuneration levels across the product providers, thereby incentivising the adviser to select the recommended product on the basis of their remuneration. On the other hand, some QFEs may actually neutralise any remuneration bias by ensuring the remuneration

payable to the adviser is equal across all approved product providers, even though the remuneration payable to the QFE by the product providers may differ.

Whenever distribution channels can determine which product providers to recommend, those product providers must then compete for that distribution. This competition between product providers is what drives increasing value to consumers and is therefore extremely important for the New Zealand public.

It is important, therefore, that a consumer is able to determine whether the advice they receive is limited in respect of product choice. This knowledge would then enable them to seek alternative or additional advice, should that limitation be of significant concern to them.

While it could be considered apparent to consumers that some advisers are restricted in terms of product choice, for example, where an adviser acts under the product provider's brand (e.g. AMP Adviser or Westpac employee), there is still a risk that in the face to face advice situation, the adviser may imply that they have knowledge about the comparative value of new products or, even more concerning, about existing policies, from other providers, when in fact they do not.

To ensure consumers are able to make an informed decision about whether product choice is important to them, disclosure of an adviser's access to product choice is a logical solution.

This can be achieved by requiring all advisers, whether AFAs, RFAs or QFE Advisers, to list the product providers they are contractually able to provide the consumer with access to and with informed advice about.

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APPENDIX TWO

Minimum Life Insurance Adviser Qualification Curriculum

Advice versus Sales or Order Taking

Partners Life contends that as soon as any client receives advice about their specific needs and the solutions to meeting those needs, then the adviser providing that advice should have to be competent to give personalised advice.

We acknowledge that if a consumer is simply being sold a product, are not being advised on whether the product is to meet any specific needs they might have, and are not in any way provided with opinion about the comparative value of the product versus any existing product or any competitive product, then advice is not being provided and the requirement for minimum qualifications do not need to apply.

Background to Curriculum

Each RFA must take responsibility for their own advice and compliance processes, and QFEs take this responsibility on behalf of their advisers. However, as there is no minimum qualification/education threshold at present for RFAs or QFE advisers, consumers can still be exposed to poor advice about Category 2 products (which includes life insurance), given that the advice is delivered face to face, and is therefore difficult to control – even by a QFE.

Category 2 products, and in particular Life Insurance products, have a significant financial impact on the lives of clients. So poor advice at point of sale can lead to poor outcomes for of those clients at claims time, which is likely to be a very vulnerable time for them. The reputation of the life insurance industry is largely based on client outcomes at claims time, so the impact of poor advice is significant to the industry and to the client.

By ensuring all advisers (giving face to face advice to consumers about Category 2 products) meet a minimum knowledge benchmark regarding the products they are advising on, the risk of consumers receiving poor advice due to product ignorance on the part of the adviser can be minimised.

From a structural perspective, QFEs are already well placed to implement and enforce minimum qualification/experience criteria on their own advisers. RFAs, however, must be provided with access to training in order to meet the criteria.

Dealer Groups who represent a significant number of current RFAs could be the providers of such training, as could product providers for each Category 2 product type.

The keys to implementation of a minimum education/experience criteria are firstly having a defined curriculum, which each training provider/QFE must deliver against and secondly a certification process to enable an adviser to prove they have met the minimum criteria.

Once the minimum education/experience criteria has been implemented, RFAs and QFE advisers should be banned from advising consumers on Category 2 products until they have been certified for the specific product type that they are providing advice on e.g. life insurance, fire and general insurance, mortgages etc.

As there are a significant number of advisers who have already had many years' experience of providing advice for some or all Category 2 products, it is perhaps reasonable to exempt these advisers from having to undergo the minimum training requirement for those specific product

types. On the other hand, if they do have sufficient experience, then undergoing the minimum training requirements should not be difficult for them and may in fact correct some misunderstandings and/or close some knowledge gaps that they may have had.

For the past four years, Partners Life has offered a training programme around life insurance to new RFAs. The part of the curriculum for this training programme that we think could be relevant across all adviser categories can be found in **Schedule 1** of this paper. It is likely that other product providers and/or Dealer Groups also have existing training programmes in place. Reviewing the current curriculum of each of these courses should enable a standard curriculum to be determined.

If a minimum experience criteria in order to be exempted from the training criteria is preferred, then a minimum of three years' experience of providing advice on the particular Category 2 product type should be sufficient (so as long as that experience can be evidenced).

ADVISER BASICS

CONSUMER LEGISLATION

FAIR TRADING ACT
CONSUMERS GUARANTEE ACT
PRIVACY ACT
ADMINISTRATION ACT
MINORS CONTRACTS ACT
HUMAN RIGHTS ACT

CLIENT EXPERIENCE TRAINING

INDUSTRY TERMINOLOGY AND JARGON

KNOW YOUR CLIENT – THE FACT FIND PROCESS

CURRENT FINANCIAL POSITION
LIFE RISKS
FUTURE LIFE GOALS
PREFERENCES
CONTINGENCY OPTIONS
EXISTING CONTRACTS
PERSONAL DETAILS

ADVISER OBLIGATIONS

FINANCIAL ADVISER DISCIPLINES

INDUSTRY REGULATION

FINANCIAL ADVISERS ACT

FINANCIAL SERVICE PROVIDERS (REGISTRATION AND DISPUTE RESOLUTION) ACT

THE FINANCIAL MARKETS AUTHORITY (FMA)

DISCLOSURE OBLIGATIONS

DISCLOSURE OBLIGATIONS

THE SIX STEP PROCESS

ESTABLISH AND DEFINE THE RELATIONSHIP WITH THE CLIENT
COLLECTING THE CLIENTS INFORMATION
ANALYSE AND ASSESS THE CLIENT'S FINANCIAL STATUS
DEVELOP THE FINANCIAL ADVICE RECOMMENDATIONS AND PRESENT THEM TO THE CLIENT
IMPLEMENT THE CLIENTS FINANCIAL ADVICE RECOMMENDATIONS
REVIEW THE CLIENT'S SITUATION

IDENTIFYING THE CLIENT'S NEEDS – THE NEEDS ANALYSIS PROCESS

LONG TERM NEEDS

THE DIFFERENCE BETWEEN FULL ADVICE AND LIMITED ADVICE

RESIDENCY, WORK VISAS AND VISITOR VISAS

Product Fundamentals

INSURANCE BACKGROUND

- The life and health insurance markets in NZ
- ACC

LIFE COVER

- Terminal Illness
- Limits on sum assured
- Exclusions
- Special events benefits and future insurability

TOTAL AND PERMANENT DISABLEMENT (TPD)

- Accelerated or Stand Alone
- Own or Any Occupation Definition
- Occupation Classifications and Ratings
- Occupational Classification and TPD Definition
- Cover Limits
- Life Cover Buy-Back Option – accelerated benefit only
- Standard Exclusions
- Special Events Benefits

TRAUMA COVER

- Comprehensive or Essential
- PricE
- Covered Conditions
- Anti-selection Stand-down Period
- Diagnosis Benefits and Partial Benefits
- Accelerated or Stand Alone
- Cover Limits
- Life Cover Buy-Back Option – accelerated benefit only
- Trauma Cover Buy-Back Option
- Standard exclusions
- Special events benefits

INCOME PROTECTION

- Occupational Classifications
- Definition of Disability
- Limits on Cover
- Calculation of Pre-disability Income
- Benefit Offsets
- Waiting periods
- Split Benefits
- Payment in Arrears or Advance
- Partial Disability Benefits
- Indemnity, Agreed Value, Loss of Earnings and Loss of Earnings Plus
- Loss of Earnings
- Loss of Earnings Plus (LOEP)
- Benefit Term and Cover Term

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STANDARD BENEFITS
STANDARD EXCLUSIONS

MORTGAGE PROTECTION

WAIVER OF PREMIUM

MEDICAL INSURANCE

PUBLIC VS PRIVATE
NON-ACUTE
ACC AND OFFSETS
TYPICAL BENEFITS
SUM ASSURED AND EXCESS
NON-PHARMAC DRUGS
STANDARD EXCLUSIONS

WORLDWIDE COVER

CPI INDEXATION

PREMIUMS

PREMIUM STRUCTURES
PREMIUM GUARANTEES

OWNERSHIP STRUCTURES

INDIVIDUAL OWNERSHIP – INDIVIDUALS
INDIVIDUAL OWNERSHIP – TRUSTS
INDIVIDUAL OWNERSHIP – OTHER ENTITIES
JOINT TENANTS
TENANTS IN COMMON

NEW BUSINESS & UNDERWRITING

NEW BUSINESS

APPLICATION PROCESS
COMPLETION
SUBMISSION

UNDERWRITING

VOLUNTARY INSURANCE
RISK CLASSIFICATION
SOURCES OF INFORMATION
UNDERWRITING
OFFER OF TERMS
DECLARATION OF CONTINUED GOOD HEALTH
LIFE TIME ACCEPTANCE TERMS
INCREASES IN COVER
IMPROVEMENTS IN RISK
NON-DISCLOSURE AND MIS-STATEMENT
Materiality
Deliberate or accidental
Reasons for non-disclosure or mis-statement

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Application time

On-going Servicing

INSURANCE COMPANIES DO PAY CLAIMS
DEATH AND TERMINAL ILLNESS CLAIMS
TRAUMA AND TPD CLAIMS
MEDICAL CLAIMS
INCOME PROTECTION, MORTGAGE REPAYMENT AND WAIVER OF PREMIUM CLAIMS
NON-DISCLOSURE AND MIS-STATEMENT
- Materiality
- Deliberate or accidental
- Identified during life of policy
- Identified at claim time

CLAIMS CONSEQUENCES
GREY CLAIMS
REGULAR REVIEWS
POLICY ANNIVERSARY
ARREARS
LAPSES
REINSTATEMENTS
POLICY ALTERATIONS
PREMIUM HOLIDAYS

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APPENDIX THREE

Commission and Life Insurance

Executive Summary

The Life Insurance industry in Australasia and around the world is a long standing, respected industry which has not experienced the reputational issues that have cyclically occurred in the savings/investment industry.

The Life Insurance industry has historically, and continues to currently, remunerate distribution channels by way of commissions and/or salaries. To link the payment of commission or salary in this industry to brand/reputational risk for investors into the industry is akin to saying the entire life insurance industry around the globe is somehow 'suspect'.

In particular, the Life Insurance industry in New Zealand has not experienced the advice 'crises' that the investment/savings industry did during the GFC.

Commissions remain the standard form of remuneration for insurance advisers around the world, including in the most heavily regulated markets.

Commissions remove a significant barrier to consumers purchasing risk protection benefits i.e. the need to pay a fee for insurance advice. Exchanging product provider remuneration with client fees would substantially increase the already large under-insurance gap in New Zealand.

Commissions enable advisers and Dealer Groups to remain independent of product providers, thereby enabling them to act on behalf of the client both at point of sale and at claim time. This also creates competition between product providers, which is to the benefit of the consumer.

Irrespective of whether commissions are paid upfront or spread, the economic cost to the consumer is about 30% of every premium for the average life of a policy.

The "Yearly Renewable Term" premium structure in New Zealand makes the upfront commission percentages paid here seem deceptively high, but the actual dollar cost of commission under level premium structures can result in much higher commission costs to the consumer, even though the upfront percentages seem lower than that paid under Yearly Renewable Term policies. This means comparing commission levels across markets can be misleading.

Background

The financial services industry is split between:

- products designed to enable consumers to accumulate and/or invest their own funds e.g. savings or investment products; and
- products where the consumer pays a premium or fee to access the funds of the product provider e.g. lending or insurances.

World-wide there has been an increasing trend over the past decade to move away from commissions being payable by product providers to advisers *upon the sale of savings/investment products*, towards fees being charged directly to the consumer for savings and investment advice.

The GFC in 2008/2009 was the catalyst for bringing poor advice practices across the investment and savings industry into the limelight with vast numbers of customers losing significant funds as

a direct result of investment advice which did not properly match their risk profiles. It was very clear that the advice being given was significantly driven by the commission potential for advisers, rather than by the client's best interests. There was *no* such crisis for the insurance advice industry.

It was very clear that the investment and savings advice industry required a significant overhaul, which was achieved through regulations and through the restructure of adviser remuneration for these products. Rather than the product provider determining the appropriate amount that the client should have deducted from their savings/investment for the advice they received, the client and the adviser now negotiated the appropriate advice fee between them i.e. the client paid the agreed fee directly to the adviser and no commission deductions were made by the product provider.

Savings and investment products are bought by consumers who are wealthy enough to have disposable income to save and/or assets to invest. Paying fees to receive investment/savings advice is both affordable and understandable to this group of consumers.

In a nutshell, while commissions on investment and savings products are not actually banned in New Zealand, they are largely considered to be inappropriate for these types of products, so advice fees have become the predominant form of adviser remuneration.

While in some markets savings and risk protection benefits are bundled together (e.g. Whole of Life, Universal Life, or unit-linked products), for the past two decades the New Zealand market has separated the two product groups from each other.

Partners Life does not sell any products which have an investment or savings component. All of Partners Life's products are pure risk protection products i.e. they are pure insurance products.

Pure insurance products are generally bought by consumers who need to protect their incomes and/or cover their debts in the event of ill health or death, because they do not have sufficient wealth to self-insure.

For New Zealand consumers, risk protection insurances are not something that are proactively sought out – the need for them and the types and amounts of cover required generally have to be sold to them by an intermediary. *Affordability* is a key issue for these customers.

Remuneration such as salaries or commissions paid by product providers to advisers for the sale of these pure risk protection products, removes the hurdle of the customer being required to pay a "fee" for advice which they would not proactively seek, and *could not* actually afford to pay.

If clients had to agree to pay a fee to an adviser in order to receive advice on a product they don't know they need, and don't think they can afford, then the *already* substantial under insurance gap in New Zealand would become *significantly* worse.

Salaries and/or commissions paid to advisers by product providers for the sale of risk protection benefits are the norm world-wide. The UK market is considered one of the most heavily regulated financial services markets in the world and yet commissions remain the standard way advisers are remunerated for the sale of risk protection products in this market. UK regulators have recognised that consumers do not "buy" risk protection benefits, they must be "sold" them, and that commissions enable advisers to fund their upfront costs of acquiring each customer.

The Australian market is also heavily regulated and also accepts commissions and/or salaries paid by product providers as an appropriate method of remuneration for the sale of risk protection products. Whilst Australia is currently looking to "spread" commissions more (i.e. reducing upfront commissions to a maximum amount and increasing renewal commissions to compensate), the

structure of upfront and renewal commissions will remain a standard method of adviser remuneration for these products in this market.

The New Zealand Life Insurance Market has some other very distinct features which set it apart from other markets, including Australia in terms of commissions

Some of these unique market features are discussed in turn below:

1. Dominated by individually sold policies which are fully underwritten and are distributed through intermediaries. The group and direct markets in New Zealand remain small. New Zealand does not have any distribution of life risk products through superannuation funds.

2. While risk protection benefits are guaranteed for the life of the policy, premiums are predominantly based on a Yearly Renewable Term, which increase with age. There is some level premium business sold, but only very low levels.

3. Commissions payable on risk benefits are weighted upfront with relatively modest ongoing renewal commissions. Alternative pendulum or level commission options are available to advisers but are seldom taken. New Zealand has a two year claw-back period for upfront commissions.

4. The combination of Yearly Renewable Term premiums and upfront commissions mean upfront commissions are calculated on the first year's premium (i.e. the lowest premium the client will ever pay). It is only the smaller, renewal commissions that are payable on the annually increasing premiums over time.

5. This differs from level premium products in other markets where the upfront commission is calculated based on a significantly higher, levelled premium. So while the percentage of upfront commission payable in these markets might be lower than the NZ market, the actual dollar commission paid over the average age of the policy could be significantly higher, even though total premiums paid over that time might be similar. Comments about New Zealand's commissions being higher than other markets are often based on this misunderstanding of the differences in premium structures.

6. Economically the 'cost' to the consumer of current average upfront and level commissions is approximately 30 per cent of every premium paid over the average life of a policy.

7. Independent advisers and Independent Dealer Groups must fund all of their business activities from the commissions they receive from product providers. They are solely responsible for their fixed costs which includes advertising, lead generation costs, travel expenses, office expenses, taxes and compliance costs.

8. Upfront commissions enable independent advisers to finance the significant costs associated with acquiring a customer, while renewal commissions help fund the costs of maintaining, reviewing and conserving existing clients. If upfront commissions were not of sufficient size to fully finance these acquisition costs, then those independent advisers may have to align with a product provider in order to have these costs subsidised.

9. The ultimate 'alignment' is where an adviser is employed by a product provider meaning all advice costs are borne by the product provider. In between these two extremes, there are structures which fit along a scale.

10. All advisers are paid for distributing product, whether they are independent, employed, tied or aligned. So all advisers' remuneration, irrespective of whether it is commission based or not, drives their advice behaviour.

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APPENDIX FOUR

Conflicts of Interest and their Disclosure – Life Insurance

A significant amount of attention has been given to the potential conflict of interest created when advisers receive upfront commissions on the successful sale of a life insurance policy.

The premise of many of these discussions has been that upfront commissions create the only "conflict" between advice that is in the client's best interests and advice which is primarily driven by the adviser's remuneration.

This is simply incorrect. There are a number of potential 'conflicts of interest' in addition to commission which can inappropriately influence the advice that a consumer receives. It is therefore important that we do not simply focus on one of them and ignore the others, which would be detrimental to the consumer, and would potentially create a regulatory "uneven playing field" between different types of advisers, based purely on their remuneration structure.

Unfortunately under present regulations, there is no requirement for most of these potential conflicts of interest to be disclosed to the consumer, meaning they have limited ability to determine whether their best interests have been represented in the advice they received.

If the one of the purposes of advice regulations is to increase public confidence in financial advice, then transparency around all of these potential advice conflicts is a necessity.

If another purpose of the advice regulations is to increase consumer access to financial advice, then it is also necessary to ensure the regulatory environment is fair and consistent across all types of advisers within each product category.

As a starting point, in terms of what the potential conflicts of interest exist in life insurance advice, it is important to recognise that adviser remuneration (including through commission) on its own does not create an advice conflict. Consumers should expect to pay for professional advice (be that through commissions, fees or a combination of both) and advisers should be entitled to be remunerated for providing valuable, expert advice.

However, all forms of remuneration have the potential to create conflict. Whether that conflict arises because: one product provider pays higher commissions than another; an adviser only holds an agency agreement with one product provider and can therefore only earn a commission from that product provider; an employed adviser needs to meet certain targets to retain their role and therefore their income; or an adviser wants to earn a new remuneration from an existing client.

A list of potential conflicts of interest (which may not be exhaustive) as they apply to either new business and/or replacement business is as follows:

Potential Conflict	New Business	Replacement Business
Difference in upfront remuneration payable to adviser between the recommended product and the other product choices able to be offered to client	✓	✓
Soft-dollar incentives that the adviser is able to qualify for based on the recommended product being recommended	✓	✓

Potential Conflict	New Business	Replacement Business
The choices of product providers that the adviser is able to place business with	✓	✓
The adviser's access to independent product research	✓	✓
Any production quotas that are required to be met by the adviser for a specified product provider	✓	✓
Access to and analysis of policy wordings for existing policies which have been advised to be replaced		✓
Difference in adviser remuneration between retaining an existing policy and replacing it where replacement has been recommended		✓

One way of minimising the likelihood that the advice being provided to a consumer has been inappropriately impacted by a potential advice conflict of interest is to ensure the consumer is made fully aware of the potential conflict.

By being aware of the potential conflicts(i.e. by being informed), the consumer then has the ability to ask questions of the adviser in order to become satisfied that the advice they have received is in their best interests, irrespective of the potential conflict of interest.

Transparency of potential advice conflicts may also encourage RFAs and/or QFEs to reduce or eliminate some of these potential conflicts of interest.

APPENDIX FIVE

Life Insurance and Replacement Business

Background

What is replacement business?

There is no current industry agreed definition of what constitutes "replacement" business. Theoretically, the definition it could/should be: all or part of an inforce sum insured for a specific benefit that is cancelled from the existing product provider and reissued with a new product provider (if those two actions occur within six months of each other). If the newly issued sum assured is less or equal to the cancelled sum assured, then the new benefit should/could be considered replacement business. Any additional sum assured should/could be considered as new business.

This might seem logical and relatively straight forward, and for straight life cover it is. However without a definition of which other benefits are equivalent to each other, confusion can exist around whether one company's income cover benefit should be considered as replacement for another company's mortgage repayment cover, for example. While they both effectively insure the client's financial position in the event of a disability, from an adviser and/or client perspective they might be considered to be completely different benefits, serving different purposes.

With each product provider branding their version of various products differently (e.g. trauma cover, critical illness cover, living assurance cover etc.), it would be very difficult for a client to understand whether they were being advised to buy a new type of benefit or whether they were in fact being advised to replace an inforce benefit.

One potential way to define replacement business without the confusion of trying to match benefits would be to consider the premium a client is paying to be the inforce business and if any of that premium is moved from one product provider to another, irrespective of the types of benefits and sums assured being cancelled and issued, then that premium could/should be considered replacement business. From the client's point of view the use of this premium has remained consistent – to pay for life insurance benefits.

Reasons for replacement advice

There are a number of reasons why an adviser might recommend a client cancel their benefits with one product provider and use that premium to purchase similar or different benefits from another product provider.
They can be split into two categories, the first to better meet the needs of the client; and the second to reflect the allegiances of the adviser.

Client and adviser drivers behind replacement advice

Client Drivers	Adviser Drivers
Existing policy benefits have not been regularly upgraded meaning significant coverage difference between existing policy and new policies currently being offered in the market.	The existing policy was not written by the adviser meaning they are not receiving, or cannot receive, remuneration for that policy and they wish to.
Existing policy benefits have become relatively expensive compared to the market, and the client wants better value for money.	The existing policy was not written by the adviser and the adviser does not have an agency with the existing product provider so they cannot service the existing policy and they wish to.
Some or all of the existing benefits may no longer meet the needs of the client and the currently required benefits might not be offered at all by the existing product provider (or may be offered, but might be poorly rated). In this circumstance the client may want the convenience of having all of their benefits in one policy (e.g. one direct debit, one company to deal with for claims, servicing etc.).	The existing policy was written by the adviser, it is now out of its commission claw-back period, and the adviser wants to earn an additional "new business" remuneration for that policy.
The client's preferred adviser can no longer service their existing policy and the client would prefer to remain with their adviser so they move their policy accordingly.	The existing policy was written by the adviser but the adviser has had their agency terminated with the existing product provider so can no longer service the existing policy.
The client (or an acquaintance) has had a bad experience with their existing product provider and asks the adviser to move them to another product provider.	The existing policy has sub-standard acceptance terms, the client's health has not improved (or might even have deteriorated) but the adviser wishes to move the policy to earn a new business remuneration and therefore guides the client into misstating their current health to the new product provider, to achieve better acceptance terms.
The client believes their health has improved but the existing product provider will not review premium loadings or exclusions, whereas a new product provider might offer better terms.	The client's health has improved meaning existing premium loadings and/or exclusions can be reviewed, however, doing so on the existing policy will either reduce or maintain the client's existing premium, therefore potentially reducing renewal commissions - whereas replacing the policy with a new product provider might result in both a cheaper premium for the client and a new business commission for the adviser. The adviser may not therefore give the existing product provider the opportunity to re-underwrite the policy.
The client has had a bad experience with their existing adviser and seeks a new adviser who restructures the client's coverages to better meet their needs.	The adviser has limited knowledge and/or access to information and as a result believes the product that they can sell is at least the same if not better than any existing benefits the client may have in place and should therefore always be replaced.

Additional risks to the client for replacement business over new business

There are three key additional risks to a client when moving existing coverages from one product provider to another. They are categorised as claims risk, health risk and premium risk.

Claims Risk	Health Risk	Premium Risk
The existing policy may have already been inforce for several years meaning any automatic stand-down periods that apply to some benefits	The client's health has deteriorated since they were underwritten for their existing policy. This deterioration in health would	The client's current policy has a different premium structure than the new policy meaning the premium looks

Claims Risk	Health Risk	Premium Risk
will have expired e.g. 13 month suicide stand-down for life cover and 90 day stand-down period for some trauma conditions. Any replacement benefits may see these stand-down periods re-start effectively leading to an interruption in coverage during which time the client (previously covered for those conditions/events) would not be covered.	therefore be covered under their existing policy. However, unless the client fully discloses their current health profile (including the deterioration to the new product provider), they risk not being covered at all under their new policy. Further, because they have cancelled their existing policy, they would no longer be covered under that policy either. If a client non-disclosed for new business they may not be covered either, but they would effectively not have lost anything as they weren't covered previously. The additional risk for replacement business is that the client might be cancelling guaranteed coverage and swapping it for no coverage at all.	cheaper on "day one" with the new policy but may prove to be considerably more expensive over time. For example, the existing policy may have a level premium, which is only a short-period of time away from becoming cheaper than the "Yearly Renewable Term" premium would be, however, the replacement policy's Yearly Renewable Term which looks cheaper on day one but will rapidly become more expensive in the next couple of years. Unless the adviser makes the client aware of this they would most likely not be informed enough to understand the implications.
The legal "test" for non-disclosure/misstatement to be relied on by an insurer to avoid claims differs within the first three years of a policy and thereafter. The test becomes much tougher for an insurer once the initial three year period has expired. This means a client who moves a long-standing inforce policy to a new policy will again be exposed to a higher risk of claims declinature due to non-disclosure misstatement than may have applied to their existing policy.	Advisers who wish to make the application process for replacement benefits quicker and easier for the client, may inadvertently (or deliberately) trivialise the application completion process increasing the risk that the client unknowingly but materially non-discloses or makes misstatements on the replacement application form.	The new product provider's premium curve is different than the existing product provider's meaning the premium for the client's current age may seem cheaper but as the client ages, the new policy could become more expensive so the client pays more over the following ten years than they might have with their existing provider. Unless the adviser makes the client aware of this they would most likely not be informed enough to understand the implications.
The existing benefits may have included features which were advantageous to the client but which are no longer available in the market e.g. life-time benefits under income protection policies. As these features are no longer available in the market, replacing these benefits will automatically reduce the client's coverage. Unless the adviser makes the client aware of this they would most likely not be informed enough to understand the implications.		The existing policy may include loyalty premium discounts which increase (or take effect) over time. Replacing these policies could mean that the client never achieves the benefits that they have effectively been paying for and may be on the verge of benefiting from. Unless the adviser makes the client aware of this they would most likely not be informed enough to understand the implications.
The existing policy may include loyalty benefits that become available after a period of time. Replacing these policies could mean that the client never achieves the benefits that they have effectively been paying for and		

Claims Risk	Health Risk	Premium Risk
may be on the verge of benefiting from. Unless the adviser makes the client aware of this they would most likely not be informed enough to understand the implications.		
The existing benefits may be a better match for the client's needs than the new ones being recommended by the adviser meaning the client is swapping inferior cover for superior cover and is therefore not benefitting from replacing their existing policy despite taking the increased risks.		
The recommended 'new' benefits are not actually the best available to meet the client's needs so they are effectively taking the risks of moving but to a lesser advantage than is available to them.		

Product providers and replacement business

All product providers currently accept and remunerate their advisers for replacement business which is being moved **to them** from another product provider. Some product providers even remunerate their advisers for re-writing their own old policies (in some of these cases the product provider benefits more from the replacement into the new product than the client does).

A number of product providers have proactively campaigned to encourage replacement business to be moved to them from their competitors through special underwriting or commission deals. This incoming "replacement" business is recorded as "new business" by the industry.

However, all product providers are united in their concern over replacement business which is moved **away from them** to a competitor. This outward replacement business is recorded as "lapses" by the industry and these lapse rates have a significant impact on the profitability and sustainability of the industry.

Product providers often claim "churn" is ruining the industry i.e. that advisers are regularly moving their inforce books from one product provider to another in order to earn new commissions from old clients. The reality is that replacement business is an option that is considered almost every time an adviser comes across a client who has existing benefits, irrespective of whether: the adviser wrote the existing policy or not; or the adviser is an AFA, RFA or belongs to a QFE.

Unfortunately the industry has not taken a strong stance in terms of agreeing a compulsory replacement business process which must be followed by all advisers in order to ensure the client is making a fully informed replacement decision. In addition, the industry has not adopted an agreed underwriting process for replacement business to ensure the client is not exposed to any risk of non-disclosure or misstatement during the replacement application process.

As a result, product providers would not necessarily know which of their new business applications were for replacement business, nor would they know which of their lapsed policies were in fact being replaced.

One of the most proactive ways a product provider can defend against having their business replaced is to compete on the basis of their customer value proposition i.e. to ensure their client is not actually measurably better off moving their policy to another product provider. Not all product providers currently choose to compete on the value they add to the client in terms of coverage

and/or price. Some choose instead to compete by "controlling" the distribution channel which can lead to products that are primarily designed for adviser ease at the point of sale, rather than client coverage at the point of claim.

Even when a product provider is actually providing the best value proposition for their client, unless the adviser is able and/or willing to understand and to explain this to the client, replacement business will still occur – particularly given the remuneration incentive for an adviser to do so.

A number of product providers have therefore recommended commission changes for replacement business to reduce the incentive for "churn" in order to address the profitability impact to the industry of deteriorating lapse rates, and the claims and health risks to the client if replacement business advice is not given correctly.

As all advisers, whether remunerated by commission or otherwise, are financially incentivised to encourage replacement business, without regulated replacement business processes for replacement advice and replacement underwriting, the issue will not be adequately addressed by these recommendations and will, in fact, create an uneven playing field for commissioned advisers versus salaried advisers, even though the same issues exist with both.

New product/existing policy research, premium comparisons and replacement business advice

There are two main risk product research engines currently operating in New Zealand, which are independent from product providers.

The methodologies used to rate product features and benefits differ between the two resulting in some differences in ratings for different products, however, on balance they are fairly consistent with each other.

At the moment both Research Engines provide ratings for products currently available to be purchased.

Only one of these provides access to research of old policy wordings – although this feature is not necessarily widely understood or used.

As a result, the vast majority of advisers (generally RFAs and AFAs) using these research engines to support their recommendations, will only be comparing new policy wordings with new products, even though they might be giving replacement advice on an older version of a product.

This clearly has limitations in terms of identifying features and benefits in existing policies which are beneficial to the client and are not available (and therefore not researched) in new products.

To further complicate replacement business advice, the existing product provider may be reluctant to (or unable to) provide the adviser with the policy wordings which apply to the existing policy (perhaps because they do not want to assist the adviser to move the existing policy). However this means that unless the client has access to their original policy document, the adviser is providing replacement advice "blind" to the details of the policy they are providing replacement advice on.

Both research engines also provide the facility for a user to remove selected product providers. By doing so the ratings of the remaining product providers adjusts to only reflect the relative rating against the selected product providers. To illustrate:

Original pool of product providers:

Product provider	A	B	C	D	E	F	G	H
Rating	2	4	6	8	1	3	5	7

The adviser removes the product providers he does not want to be included in the ratings:

Product provider	C	F	G	H
**adjustment*	*Previously 6*	*Previously 3*	*Previously 5*	*Previously 7*
Rating	3	1	2	4

As this illustrates, by removing companies that rank better than the adviser's preferred provider, they are able to justify advice that might not be in the client's best interests, and the client would not be aware that there were other options that would have been available to them.

While this is certainly problematic for new business advice, for replacement advice it is even more problematic given the additional risks the client is taking and the limitations on the advantage they are potentially trading the risks for, given this manipulation of the research.

Premium comparisons are also problematic for clients who are being advised to replace benefits as they rely totally on the adviser to determine which products to quote and present - meaning they might not be presented with the best value for money options. In addition, while illustrations do provide accumulated premium projections over one, three and ten years, unless the client is advised about the implications of these, they will naturally be likely to only pay attention to the initial premium quoted on the front of the illustration.

Even if the adviser did highlight the accumulated premiums to the client, if the client has loyalty benefits included in their existing policy, the impact of these will not be accurately portrayed in a new quote for that existing product provider, rather it is likely a bespoke illustration would need to be obtained from the existing product provider – who again may be reluctant to do the work for the adviser, given the reason it is being requested. Again this means the client could be blind to the actual impact of the replacement advice on the difference in premiums they might pay over time.

A number of advisers (some RFAs and potentially a large number of QFE advisers) do not have access to any independent product research when giving replacement advice, but are still incentivised to do so by sales quotas, bonuses, commissions etc. This means that they, and therefore the clients, are completely blind to the risks they are taking and the comparative value of the benefits they are being advised to replace their existing policy with.

Adviser remuneration and replacement advice

As the industry currently stands, all advisers irrespective of whether they are employed, tied, aligned or independent, receive the same remuneration for writing replacement business as they do for writing new business.

The remuneration paid to an adviser for the placement of new business is designed to support the effort required to find new clients, convince them of the merits of insurance benefits and that they should buy them, and then progress the application through the underwriting and issue process, taking into consideration the percentage of cases that will not proceed to issue.

With replacement business, the work to find and sell the need to the client, has already been done. The work for replacement business should therefore be more focussed on the risks and benefits of replacing the old policy with the new one.

As the two pieces of work are quite different, it could be questioned why the same level of remuneration is paid for them.

The current remuneration structure leads to a situation where the adviser can financially benefit significantly more by recommending the client replace existing benefits, than by recommending they retain them.

Advisers who are remunerated by commissions are to some extent disincentivised to replace policies they themselves have previously written with a product provider. For example advisers:

- are subject to commission claw-backs on policies (including increases) that have been issued within the past two years;
- have persistency hurdles they must meet to participate in incentives (such as offshore conferences etc.) or even to retain an agency agreement with a company; and
- have persistency bonuses that would be forfeited if their book persistency falls below a threshold.

Other advisers may be prevented from replacing policies they themselves have previously written as they do not have access to other product providers to move their clients to. These may be both salaried and/or commissioned advisers.

Most product providers do not allow an adviser to replace a policy that already exists with that product provider with a new one, irrespective of whether the adviser wrote the original policy or not (with the exception mentioned above).

Unfortunately there is nothing currently that would effectively disincentivise an adviser from recommending the replacement of policies previously written by another adviser, with a new product provider - who would then pay them a new-business remuneration (other than potentially the client's best interests).

It is important to note that any new business remuneration is an incentive to write replacement business, irrespective of whether that is by way of commission, salary (which might be dependent on new business sales targets), bonuses or other remuneration. To put it plainly, retaining one's job is just as much of an incentive as receiving a commission.

Recommended replacement business process

As outlined above there are some significant issues surrounding the advice on replacement business which can be summarised as follows:

1. Significant remuneration incentive for all advisers to recommend replacing existing benefits.

2. Significant new business incentive for product providers to encourage replacement business **to them**.

3. Potential claims, health and premium risks to client in replacing existing benefits.

4. Limited access to information about existing policies to ensure those risks are fully understood by the adviser and adequately relayed to the client.

5. Significant risk to industry profitability from deteriorating persistency rates, driven in part by replacement business.

6. Extremely limited ability for client to make an informed decision about the relevance to them of any replacement advice.

7. Risk to industry reputation arising from high claims risk for clients regarding replaced policies.

For replacement advice to be demonstrated to be in the client's best interests the following components need to be in place:

1. An agreed definition of replacement business needs to be adopted – our recommendation is that any premium the client is already paying (and has therefore paid a new business remuneration for) which is cancelled from one product and reissued with another (within six months either side of the commencement date of the new policy) be considered as replacement business, irrespective of the mix of benefit types and sums insured.

2. Advisers must be trained/educated specifically about the claims, health and premium risks to the client which can arise when replacing business. If the adviser does not meet these minimum training requirements they should be banned from providing replacement advice (the client can still insist on replacement but not on the basis of any advice to do so).

3. Advisers must be able to access and analyse the specific policy wordings which apply to the client's existing policy (before providing replacement advice) - whether through the independent research engines or from the product providers themselves. Product providers should be forced to provide policy wordings (including upgrades) to clients when requested (theoretically this could help them retain clients rather than encourage replacement). If the client/adviser does not obtain the policy wordings of the existing policy then the adviser should be banned from recommending replacement (the client can still insist on it, however).

4. Advisers must provide a recommendation which proves the replacement rather than retention of existing benefits is [best OR in the client's best interests].

5. Advisers must disclose the difference in remuneration they stand to receive between retaining the existing policy and replacing it with a new policy.

6. Advisers must have to notify the new product provider that the application is all or in part replacing existing benefits.

7. Product providers who receive replacement business applications must underwrite the application in such a way that the client cannot be exposed to non-disclosure/misstatement being discovered at point of claim (i.e. for replacement business, non-disclosure and misstatement cannot be used as a reason to decline a claim).

If these components are put in place, then remuneration for replacement business is less likely to be the primary driver for replacement advice. The work required to prove the conclusion that replacement business is in the client's best interests will create a dis-incentive to advisers seeking to make a quick financial gain from replacement advice. On the other hand where replacement advice is in the client's best interests, it is appropriate that remuneration is received for the significant work undertaken to reach that conclusion.

By engaging the product providers in the process i.e. to provide policy wordings for existing policies; to underwrite replacement business fully; and to remove the non-

disclosure/misstatement risk from the client for replacement business; the industry's historical role in encouraging churn can be stopped.