ADVISER REMUNERATION—

Creating positive futures for Advisers, Product Providers and New Zealanders

Commission Restructure Discussion Paper

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SECTION 1 – Introduction and Objectives

INTRODUCTION

This paper serves to be open practical discussion, directed primarily at Product providers and Advisers, but the objectives apply to the broader New Zealand Financial services industry.

The current structure of Adviser remuneration, transparency and disclosure has come under the spotlight over the past six months. Most of this has been driven by what has occurred in Australia since 2015, rather than complaints directed against New Zealand Advisers by the NZ public, who largely show little interest in Adviser Remuneration unless they have to pay for it themselves. However, this is not to say that New Zealanders who use a Financial Adviser are not concerned, but perhaps it is the lack of understanding of Adviser remuneration that drives this lack of willingness to ask the question. However, the churn report recently released by the FMA has reinforced both the need, and the opportunity to look at positive change that can change the perceptions on how Advisers are remunerated. It has also been noted in feedback from Advisers when disclosure around commission has occurred, albeit under the very confusing wide-ranging diversity between different product providers. This confusion is less desirable not only for the Consumer, but also the Adviser for tracking and accounting purposes.

It is also well known that New Zealand has an 'underinsurance' problem, and whilst this reform will not address that directly, it is envisaged that Financial Advice New Zealand will be active in this area, it will change the mind-set of the Adviser to be more pro-active in the younger age market as remuneration would support that under this model.

This model also addresses affordability not only for the Consumer, but also cost effectiveness for the Product Provider which can enable savings to be passed on to Consumers in the form of reduced premiums, improved benefits and products, and for the Adviser, make it easier to do business with the Product provider.

For the most part this paper applies to the "Risk" or personal insurance sector, but also touches on some changes we believe should apply to the mortgage/home lending sector as well.

It is the intention to work closely with Product providers. Advisers, Professional Associations and other Key Stakeholders. It will be important to see how this alternative model will positively assist the Risk and Mortgage sector to move to a fee-based remuneration model rather than the current commission model which has largely not had any changes since the concept of risk insurance was introduced. Yet, many other aspects of the industry have changed dramatically and bear little resemblance to the past.

CONSULTATION PROCESS

This paper acknowledges that a two-stage consultation process be adopted to facilitate this as follows;

STAGE ONE

Liaise with Product Providers on a one to one basis to receive feedback and address any immediate issues from a practical, logistic and actuarial perspective. Continue to liaise with FMA and MBIE throughout this period to provide feedback on progress and that the model will address some of the ground swell concerns that have been occurring from various sectors. Present a final draft version to all Product Providers, FSC, FMA and MBIE for comment. Estimated time to complete this process between three and six months to satisfy the logistics and pricing issues with each Product Provider.

It has also been acknowledged that 'awareness' with the Commerce Commission also be on the agenda in respect of removing any 'collusion perception' from the Product Provider perspective.

CURRENT PRODUCT PROVIDER DISCUSSION AND FEEDBACK

ONE PATH

Meetings with Senior Actuaries, Pricing and Product Development personnel. This was invaluable from the start to assess the feasibility of the model. It was noted by all that this type of model had not even been thought of. It was even considered to have potential for other countries to follow given it was so different to anything ever previously presented. Other countries have simply reduced the upfront commission – but still retained a commission-based model. It was also acknowledged that retaining a commission model does not change the behaviour of a few but penalises those who do a very good job. Based on that feedback, changes were made and presented to fine tune several key points. Further feedback was acknowledged from the One Path Actuary. A followup meeting is to be scheduled.

SOVEREIGN

Early meetings with the head of one of Sovereigns Key distribution channels showed enthusiasm for the model, but also with concerns on how Insurer's would be able to effectively compete if they could not use Adviser commission as a lever. This was addressed. Following a recent meeting with the Head of Distribution of Sovereign to provide an overview of the model, this then initiated a meeting with Senior Sovereign Staff in Distribution, Actuarial and Pricing. This meeting covered a more in-depth presentation of the model. Feedback then was received, discussion on some initial logistic issues but overall was positive in that it is receiving further attention from the Actuary in respect of logistics around pricing feasibility. It was also noted that this type of model had not even been considered and again, has the potential to lead a dramatic change that provides a positive outcome for everyone, Product Providers, Advisers and ultimately the Consumer. It was acknowledged that it can solve the churn issues, transparency and disclosure issues. It was also noted that it is necessary to look at all aspects of the current Adviser Remuneration model to solve issues that currently exist for Product Providers, Advisers and New Zealanders. From this discussion, the Sovereign representatives noted that it would simplify many aspects of the agreements for Advisers. In summary positive feedback outweighed the negative issues which were deemed to be easily overcome with input and consultation.

It is critical that the model has a "landing point" from which creative engagement can be then sought from core stakeholders – namely the Adviser fraternity.

ADVISER TESTING

It is acknowledged that at this point no direct feedback has been ***publicly*** sought from Financial Advisers. However, the model has been presented to the Share Group conference, PAA Regional Meetings in Waikato and Bay of Plenty and Christchurch. One on one meetings have also been with young Advisers with less than three years in the industry and with an Auckland based Adviser group of more than five years in the industry.

The purpose of those meetings was threefold;

- to gauge the level of willingness to engage and have the conversation

AND

- to assess if there was any significant negative feedback as to whether the model would significantly impact an Adviser business from a revenue perspective

AND

- whether any of the above would impact the access and delivery of advice to New Zealanders

Whilst some comments were less enthusiastic, overall, the feedback was encouraging from the perspective of the first point, and that Advisers were prepared to have a conversation, and the impression was that the solution should be driven by Product Providers and Advisers as they are best positioned to create a solution that each can work with. Clearly there was less appetite for a solution to be driven from a regulatory perspective or based upon what has occurred in Australia recently. It was noted that New Zealand should be able to achieve a better solution and have something more innovative that is lead by the industry. The opportunity to get the discussion of commission off the table once and for all was also noted by many. The PAA and IFA are aware of this paper which has been circulated to them previously. However, it was not viewed as a subject to have at the time due to other more pressing tasks such as FSLAB, creation of Financial Advice New Zealand and now the Code Review. The sensitivity of the subject was also noted in respect of membership.

STAGE TWO

Present 'Landing Paper' to Professional Associations, Adviser Groups and boutique operations. Schedule a regional road show to present the Landing Document. Call for submissions and feedback from the Adviser Sector. Anticipate this to be a three and up to six-month process.

OBJECTIVE

To have an agreed, approved and transparent Adviser Remuneration model that supports long term business sustainability for the providers of financial advice to New Zealanders

To ensure Adviser businesses can support certainty of access to advice, delivery of advice, and better outcomes through transparency and disclosure to all New Zealanders

To ensure New Zealanders can implement affordable solutions to achieve their financial objectives. This will be driven out of the solutions to the churn issues facing Product Providers and the reduced acquisition costs to Product Providers.

This paper should not be taken that its content has been agreed or discussed with the wider Adviser fraternity. This paper has not been discussed with every Product provider but will be part of a process that is ongoing. The purpose is to seek comment, feedback and a willingness achieve the objectives previously referred. Limited engagement has occurred with the existing Professional Associations at present for the reasons previously stated.

At present we are discussing the proposal individually with Product providers and Advisers to gauge support for change – change that is believed to be significantly better than any of the reforms implemented overseas.

SECTION 2 – The state of the nation

A CALL FOR SIMPLICITY

Current commission models are complex, cumbersome and confusing. Many Advisers find the commission models for the various Product Providers a challenge – especially if trying to reconcile accounts. Many Accountants struggle with the different commission models for Product providers. Below is an example of four Product Providers just to illustrate this;

COMPANY A

Initial Commission 200% first year premium (Life Only)

OR 150% all other benefits

Renewal 7.5%

COMPANY B

Initial Commission 87.5% first year premium except

80% first year premium disability products

200% for Rate for Age Life Insurance

OR 30% Health insurance

PLUS

Up to an 80% bonus of the initial commission

PLUS

Up to 15% quality booster bonus of the initial commission

(This is based on a rolling 12 month Adviser book persistency.)

AND 80% bonus of the quality booster bonus

Renewal commission initially 7.5% but this goes up to 10% when the policy reaches its 10th year.

COMPANY C

Initial commission of between 100% - 200%

Additional performance bonus on top initial commission (sales linked)

COMPANY D

Initial commission 100% of first year's premium

PLUS Bonus based on persistency and/or sales

Renewal Commission is between 3.5% to 7%

LEVEL PREMIUM PRODUCTS

This can vary between Product Providers but is typically between 120 – 180% of the first-year premium. However, renewal commission is paid at a lower rate as well than variable rate for age premium structures. It is little wonder that 'level premium' contracts feature lower on the solutions menu than rate for age premium products.

THE LOW DOWN ON TRAIL OR RENEWAL COMMISSION

If the only revenue option to an Adviser for providing an ongoing service to clients such as an annual review is renewal or trail commission, then this potentially provides a conflict for Advisers when a client is in arrears on their insurance or mortgage as the Adviser will not receive any renewal or trail commission until the insurance or mortgage is brought up to date. It is to be noted that an Adviser can spend significant time to work with a client to assist them if they are facing a period of financial uncertainty, and much of this work currently goes unpaid for Advisers who are pro-active in this space.

This model acknowledges and considers that it is not the level of remuneration that an Adviser receives that is at question – but the perception based on how commission is currently quantified and the aforementioned complexity for stakeholders. Furthermore, this new model has the potential to address this issue for Advisers in the long-term.

SECTION 3 – Confusion leads to lack of Transparency

CONFUSION

Various Product Providers have over the past five years stated various time frames before a Life Insurance policy reaches profitability. This has been anywhere from between three years to seven years. This is however affected by the type of product and other fundamentals such as actuarial assumptions and claims experience unique to the particular Product provider. For an Adviser, profitability does not occur until the policy has reached its third year. Why? Simply because should the client cancel or change the policy within two years the Adviser is liable to pay back up to 100% of remuneration received – of course this is on a sliding scale.

Over the past twelve months many product providers have at some stage suggested that commission has to change, and that profitability is of concern based on current levels. However, those same Product Providers have also all offered increased commissions as well as other incentives in the same breath – therefore manipulating Adviser behaviour to gain market share. Contrary to some industry commentary, this paper suggests the term 'incentive' (as it relates to offshore conferences for example) would not be a problem if some structure is placed around them. It is also acknowledged that such incentives (often referred to as 'soft dollars') and that they have been a marketing program just like any other commercial identity to gain business. This paper would also propose that any method of acknowledging support an Adviser gives a Product Provider in the way of volume should be focused on business support or business growth – which could be in the form of a business conference for an Adviser. The most critical component to disincentivise Advisers is that any offshore reward or acknowledgement as currently offered by some Product Providers are ***not*** advertised or marketed within the industry. Rather, Product Providers monitor the performance of Advisers relative to their own business model and invite those they feel qualify to attend at a future point in time. The qualification criteria might be measured on persistency (thereby linked indirectly to quality of busines), business process and production or a combination of these and other criteria at the Product Provider discretion. This then totally removes any upfront incentive to place a level of business with one particular company or brand.

This model supports and endorses a consumer centric focused business and Adviser performance which could be validated annually by the Product Provider. In this respect, persistency should be part of that 'quality' measurement as it is one indicator, but not the only indicator of Adviser integrity. However, persistency needs to be put into balance in that it should not include cancellations that are due to a change in client circumstances which are legitimate reasons for cancellations and reductions. This does not mean that the Adviser should not be released of the responsibility of a clawback of remuneration – as the Product provider also suffers a loss within the first two-year period, but it should not negatively impact Adviser persistency – which is a key element to this new model as discussed later.

SECTION 4 – Clawback of revenue

LAPSES AND CLAWBACKS

Currently the industry standard is as follows;

Within first twelve months - 100% clawback

Between 12 and 24 months - sliding scale down to zero

More recently with regulation there has been evidence of Advisers incorporating various clauses in Disclosure Statements that require the client to repay a fee back to the Adviser should the client cancel business within the first two years. There have also been examples of Advisers getting into disputes because of inappropriate wording that make reference to a clawback of commission. This has caused a lack of transparency around the Adviser/Client relationship in respect of setting clear expectations of the client from the outset.

This could be managed through a change in focus on how clawbacks are imposed if they are linked to quality of business rather than quantity as referred above.

INDUSTRY SHIFT

For the industry to move forward, this will require ***all*** Product providers to adopt any new model, or a model along similar lines as to that proposed in this discussion document. Any proposed change ***will*** require support of the Professional Associations who can assist significantly in helping Advisers to adopt the new regime. Professional Associations are relevant and important, and members look to their Professional Body for support and endorsement of significant change to the industry when it affects their business and livelihood. Professional Bodies have in the past been seen to advocate only for Advisers, but a change is needed so that they are seen to advocate for better industry function.

SECTION 5 – From commission to fee

PROPOSAL

REMOVE	REPLACE WITH
Initial Upfront Commission	Implementation Fee or;
	Setup Fee or;
	Professional Fee
	Fee based on % of sum assured
Renewal Commission or;	Service Fee or;
Trail Commission	Review Fee
	Fee based as a % of Annual Premium**

Remove all other references to bonuses, additional commissions, loyalty commissions and aggregation commissions.

INITIAL FORMULA'S

As referenced earlier in this document, it is not the level of remuneration that should be debated, but the terminology structure and disclosure that is used.

Workings for the **Implementation Fee** proposed as follows;

BENEFIT	FEE
Stand Alone Benefit (Lump Sum Assured) <$200,000	up to 1.00% fee of the sum assured.
Stand Alone Benefit (Lump Sum Assured) >$200,000	up to 0.4% fee of the sum assured.
Accelerated Lump Sum Benefits	up to 0.5% fee of accelerated sum assured.
Income Benefits < $60,000	up to 3% fee of the sum assured
Income Benefits > $60,000	up to 2.5% fee of the sum assured
Health Benefits	Flat fee of up to 30% of premium ***or***
	A flat fee

The following examples are based on the maximum Implementation Fee chargeable by the Adviser of up to 1.0% for sums assured under $200,000 and up to 0.4% for sums assured $200,000 and over and of actual cases issued in 2016.

EXAMPLE A

Couple, aged 28 years, NS Occupation Class 3

PRODUCT	SUM ASSURED	FEE	PREMIUM	COMMISSION
Life Insurance	400000.00	$ 1,600.00	$ 47.21	$ 1,303.00
Trauma	140000.00	$ 1,400.00	$ 37.15	$ 802.44
TPD	395000.00	$ 1,975.00	$ 51.47	$ 1,111.75
Income Benefit	24000.00	$ 720.00	$ 98.28	$ 1,415.23
Health Insurance		$ -	$ -	$ -
TOTAL REMUNERATION		$ 5,695.00		$ 4,632.42

EXAMPLE B

Single female aged 52 – Trauma Only

PRODUCT	SUM ASSURED	FEE	PREMIUM	COMMISSION
Life Insurance	0.00	$ -	$ -	$ -
Trauma	100000.00	$ 1,000.00	$ 104.26	$ 2,252.02
TPD	0.00	$ -	$ -	$ -
Income Benefit	0.00	$ -	$ -	$ -
Health Insurance		$ -	$ -	$ -
TOTAL REMUNERATION		$ 1,000.00		$ 2,252.02

EXAMPLE C

Single Male aged 53 – Trauma only with a 100% loading NS

PRODUCT	SUM ASSURED	FEE	PREMIUM	COMMISSION
Life Insurance	0.00	$ -	$ -	$ -
Trauma	200000.00	$ 1,000.00	$ 529.56	$ 10,803.02
TPD	0.00	$ -	$ -	$ -
Income Benefit	0.00	$ -	$ -	$ -
Health Insurance		$ -	$ -	$ -
TOTAL REMUNERATION		$ 1,000.00		$ 10,803.02

EXAMPLE D

Business partners aged 37 and 48, Males NS Occupation Class 3

PRODUCT	SUM ASSURED	FEE	PREMIUM	COMMISSION
Life Insurance	100000.00	$ 1,000.00	$ 31.51	$ 869.68
Trauma	100000.00	$ 1,000.00	$ 74.23	$ 1,514.29
TPD	100000.00	$ 1,000.00	$ 33.76	$ 729.22
Income Benefit	0.00	$ -	$ -	$ -
Health Insurance		$ -	$ -	$ -
TOTAL REMUNERATION		$ 3,000.00		$ 3,113.18

EXAMPLE E

Business Key person aged 48, Male, NS Occupation Class 3

PRODUCT	SUM ASSURED	FEE	PREMIUM	COMMISSION
Life Insurance	360000.00	$ 1,440.00	$ 61.78	$ 1,705.13
Trauma	0.00	$ -	$ -	$ -
TPD	360000.00	$ 1,800.00	$ 81.59	$ 1,762.34
Income Benefit	0.00	$ -	$ -	$ -
Health Insurance		$ -	$ -	$ -
TOTAL REMUNERATION		$ 3,240.00		$ 3,467.47

Further input is sought from Product Provider Actuaries in respect of the percentage formula's that would ensure consistency across all Product Providers.

The Product Provider will be responsible for the payment of the Implementation or Setup Fee and the ongoing Service Fee.

ANNUAL REVENUE BASED ON THE PREVIOUS EXAMPLES WITH A PERSISTENCY OF 93%

	TOTAL FEES		TOTAL COMMISSION
	$ 17,141.00		$ 25,924.00
		Less Loading	$ 5,713.00
SUB TOTAL	**$ 17,141.00**		**$ 20,211.00**
Service Fees	**$ 4,536.00**	**Trails**	**$ 1,701.00**
TOTAL	**$ 21,677.00**	**TOTAL**	**$ 21,912.00**

Based on >93% persistency

SECTION 6 – How Churn is addressed

PERSISTENCY

Getting a ***consistent*** formula right for measuring persistency is critical for all parties. This paper proposes that in all cases a clawback of the implementation fee or set up fee is incurred within a set period. This is based on the reality that not all events that cause the cancellation of business should unfairly affect the persistency of an Adviser.

EVENTS EXEMPT FROM ADVISER PERSISTENCY

Based on the rationale for the existing original cover no longer being relevant to the client then it is proposed that specific circumstances will be exempt from measuring persistency of an Adviser Business performance such as;

- Client reduces debt that therefore reduces client risk and ultimately sum assured
- Client moves overseas and no longer living in New Zealand
- Client goes through a relationship separation
- Client sells a business or Company
- Client wishes to upgrade
- Client is seeking a review of medical exclusions or loadings

The above is not necessarily an exhaustive or conclusive list

FOOTNOTE: An Adviser should not be penalised for logical financial literacy.

A simple updated disclosure from the client could be all that is required for this to be implemented - similar to an updated statement of position when a client applies for an increase to existing mortgage lending.

It is not necessary to have a list of events that do affect persistency. If it is not on the exempt list, then it will affect persistency.

It is also important to note that ***any business*** that is lost by an Adviser within their ‘individual persistency/responsibility period will result in an invoice generated by the Product Provider to the Adviser. This is no different to the current standards albeit the responsibility period will differ based on the Advisers individual persistency/responsibility period. This is outlined in the next section.

PERSISTENCY AND FEES

That the level of fees the Adviser can charge back to the Insurer should be linked to persistency as follows;

PERSISTENCY	FEE RANGE
Consideration for those with a Persistency of >98%	***Responsibility Period 6 months***
Greater than 95%	up to 1.00% Implementation fee
	20% Service Fee
	Responsibility Period 12 months
92 – 95%	up to 1.00% Implementation fee
	20% Service Fee
	Responsibility Period 18 months
90 – 92%	up to 0.9% Implementation fee
	15% Service Fee
	Responsibility Period 24 months
< 90%	up to 0.85% Implementation fee
	10% Service Fee
	Responsibility Period 36 months

SERVICE FEES

Evidence for payment of 'service fee' to an Adviser will not be necessary as the fee for service is paid by the Product Provider, and the Advisers Disclosure Statement can adequately cover this clearly to the client. However, a simple statement to confirm the client has been offered, or had a review conducted at the clients' request can be included in the Adviser process. The Product Provider could at any time call upon this evidence to confirm the ongoing payment at any stage. Should a client request the change of an Adviser, then they would send this request to the existing Adviser and the Product Provider, and this would activate the change of the payment of the existing service fee to the new Adviser.

For all intended purposes, the service fee is paid to the Adviser servicing the client unless the client, or in some circumstances the Adviser, notifies otherwise.

REPLACEMENT BUSINESS FEES

Suggest that the Implementation Fee be changed as follows for replacement business for a ***new Adviser*** but not the ***originating Adviser*** who may be impacted by the Persistency Formulas;

Within two years	$250 fee maximum
Between 2 and 4 years	$500 fee maximum
After four years	Full Entitlement of Implementation Fee

However, the Adviser will still be entitled to the ***full service fee*** that applies based on their individual Persistency Rating.

OUTCOME:

Advisers will be dis-incentivised to switch policies or client business between Product Providers.

Better and more sustainable Adviser business models

SECTION 7 – Larger Adviser Business Models

AGGREGATOR AND PRODUCER GROUPS

As an industry we need to acknowledge the various Business models in existence, however, this section refers to large groups of Advisers who form the typical Aggregator Group. It is important to acknowledge the role they play in providing tools to their Adviser members that aim to provide a better consumer experience, and better process and value for the Adviser. Aggregator groups also supposedly have lower costs through economies of scale. Previous papers that have tried to address Adviser commission and 'churn' have imposed considerable reduction in revenue to this Business model which is potentially anti-competitive and could result in being detrimental to the consumer.

It remains unclear as to why this model of paying over-rider commissions and bonuses still exists, given that it also incentivises unfair leveraging from an Aggregator to a Product Provider against the volume of business produced by the Aggregator Group for increased commissions and bonuses with no responsibility. In some cases, this has caused some serious issues for Product Providers in the past.

It is also a concern that some Product Providers are focused on the commercial outcome of large premium volume without consideration in how this affects New Zealanders during the advice process. It is a bold statement, but equally a true one that some Product Providers are guilty of driving these less than fair business practices within some Adviser Aggregator Groups, and it is expected that this would be strongly debated.

However, the opposite is also true in that some Aggregator or Adviser Groups have adopted a much better business model – and with the advent of the current Adviser Network Group a common sharing of improving this business models and working alongside Professional Associations where each responds to the needs of the other and in turn lifts the level of service to the consumer should be seriously encouraged. Currently, this does not work as well as it should and as a result each is in danger of significantly reducing the ability for the industry to become a 'profession'.

In cases where by an Aggregator receives additional over-rider commissions due to volume of business placed with a particular Product Provider, this structure, current terminology and process of remuneration to the Aggregator should change. Should a Product Provider pay more to receive business from one Adviser (Aggregator Group) by offsetting or indirectly subsidising the cost of the additional benefits he or she receives as part of belonging to a large Adviser Producer Group? This does not sit well with smaller Adviser business models who are not linked by agreement to any Product Provider. That the small independent Adviser has to fund his or her own expenses directly without any additional revenue being received arguably places smaller 'independent' Advisers at a disadvantage. It is also important to note that the last thing the industry needs is the death of the smaller (independent) Adviser which would result in less choice to the Consumer.

Aggregator Groups do have a very significant role to play for those Advisers and the larger industry as a whole.

A **'best of both worlds'** solution

It is acknowledged that there are cost savings to the Product Provider, in that administration costs are lower when dealing with only the Head of the Aggregator Group, for which it is reasonable to accept that those cost savings could be passed back to the Aggregator. This paper proposes that this should be in the form of an **Administration Fee** which then clearly attributes the money being received to the benefit being gained by the Product provider.

This then opens up the discussion for the Aggregator Group Advisers to become responsible for paying a fee for the benefit they receive to the Aggregator Group Head which then becomes part of disclosure and is easily more transparent to the Consumer. Currently, and arguably, there is the potential for less transparency to the Consumer. This provides several flow-on benefits that benefit everyone – the Aggregator receives fair business revenue for the administration and volume they provide to a Product provider, the Aggregator Adviser pay's the Aggregator a fee from the fee-based revenue they receive for the benefits they receive as being part of a larger Adviser Group.

In simple terms, if an Adviser joins a Group because of various benefits offered, then that Adviser should pay a fee to the Group accordingly as he or she is receiving the benefit. Aggregator Groups will therefore have to carefully consider the benefits they are providing, which is both positive and healthy as it incentivises better standards of delivery and responsibility to both parties - the Adviser and the Aggregator/Producer Group. An Insurer or Lender should ***not*** be made responsible for providing such benefits to Advisers – either the business model is sound enough to stand on its own as a viable business entity or it is not.

Whilst this viewpoint may challenge some Aggregator Groups that receive additional commission over-riders or bonuses, ultimately the industry needs to be pro-active to help these business models evolve in a positive manner as the last thing the industry needs is a decrease in access to financial advice. Therefore, the industry needs to clearly work with these business models to develop a more transparent and value-based proposition.

It is also important for the industry to learn from past errors whereby large books of business have been moved from one Insurer to another by such groups due to the reluctance of an Insurer to agree to pay additional or increased commissions to the Group. This was certainly a catalyst to the unfortunate negative perceptions bestowed upon the industry by a number of parties which has tarnished many.

PERSISTENCY MODEL TO APPLY TO AGGREGATOR GROUPS

This paper proposes that the new Persistency Model apply across the board to ALL Adviser Business Models irrespective of structure.

Therefore, should the persistency of an Adviser Group fall below the thresholds outlined in **Section Seven**, then the Advisers within that group will, depending on the current (or future licencing) structure, will have the same restrictions imposed.

OUTCOME:

- *significantly reduces the risk to the Product provider and the Consumer during the advice process*

- *contributes towards a positive and more sustainable business model*

SECTION 8 – MORTGAGE/HOME LOANS

MORTGAGE AND HOME LENDING SECTOR

To an extent, similar trends exist within the mortgage and home lending sector. However, one of the key fundamental differences is that the Lending Product Providers themselves (Banks) are competing against the Advisers they transact business with, so in effect guilty by way of sales targets to aggressively market for existing mortgage customers to 'switch'. It is very easy to incentivise a consumer to switch from Lender 'A' to Lender 'B' simply by offering better rates – something that consumers directly gain a benefit from in respect of increased disposable income. However, the short-term benefits may well be outweighed by the long-term loss of flexibility.

This is not likely to change for commercial reasons. In respect of commission formulas, this paper does not believe there is any need to change these as they are benchmarked as a percentage of the total lending which is an appropriate method. Similarly, in the investment sector fees are charged generally as a percentage of the total sum of investment – although it is also important to acknowledge some other factors also reflect fees charged, as they should also in the Insurance and Mortgage sector.

MORTGAGE COMMISSION

Typically, this is a percentage of up to 0.85% of the total amount of lending. In many cases this maximum up-front commission does not include any trail commission.

Trail commission can typically be from 0.15% to 0.25% depending on the lender and is benchmarked as a percentage of the mortgage balance. Therefore, mortgage trail will gradually decrease over the term of the mortgage. When an Adviser selects trail commission to be paid, this generally reduces the maximum up front commission down to 0.50 to 0.55% but can in some instances be outside of these parameters.

It is proposed to remove the term commission, and replace this with similar terminology as the insurance sector;

Setup fee

Service fee

New Replacement Business Rules to be developed

SERVICE FEE

If the concept of transferring over time the service fee for insurance from the Product Provider to the client is seen as difficult from both the client and Adviser perspective, it is much less so for the Adviser involved in mortgages.

However, there is a clear fundamental difference in the way Lenders acknowledge Financial Advisers for meeting with the client each year to review the mortgage, provide feedback and advice, mortgage structure, further additions to the mortgage finance etc. Many Lenders currently still do not pay a trail commission. Yet the Financial Adviser is meeting the cost of reviewing the mortgage with the customer, ensuring it continues to meet the client's needs, and in essence ensuring the mortgage stays with the existing Lender unless circumstances change that require the client to consider other Lenders for refinance.

It is a concern that more recently some Banks and Lenders are looking to hold Advisers accountable for retention even when churn is instigated by the Bank from an originating Adviser. This is being watched closely and therefore exemptions are expected to form part of the proposed Replacement Business rules.

If anything, Lenders have in the past been extremely 'pro-active' to incentivise consumers to consider refinancing, offering all kinds of "soft dollars" such as televisions, ipads, phones, cash incentives and much more with total disregard to whether this would best meet the client's needs. This includes incentivising Consumers to deal directly with the bank and not the Adviser. Whilst this type of action is allowed to continue, it is watering down the Consumers perception, awareness and access to advice. How does this meet the "place the Consumer needs first" test?

For Advisers, it has meant revisiting the client, reassuring them that their current mortgage structure is right for them and helping them revisit their financial goals in respect of reducing mortgage debt over time as quickly as possible.

Yet, little has been done to investigate this sort of behaviour which Advisers can provide plenty of evidence. More importantly, some Banks have leveraged off discounted mortgage interest rates to encourage the client to also switch their insurance away from the Adviser. This is becoming an increasing concern over the past six months. Clients state that it is purely for "commercial" reasons they are moving their business to the bank and they understand that they are happy to lose the 'advice' service.

The recommendation from this paper would be to have all Lenders recognise the reduced costs associated with reviewing the mortgage with the client and pay a service fee to the Financial Adviser.

A home loan represents the bricks and mortar that the client now owns albeit securitised by way of the mortgage to the bank. However, the perception of value is more obvious.

If the rest of the industry eventually in some future point of time move towards passing the service fee across to the client, then ultimately the same would also apply to the Adviser providing a mortgage advice service. Without doubt, is just as important for the consumer to regularly review

their mortgage, its structure, interest rates and other factors that could affect the serviceability of the mortgage over time.

This is currently being done by many Advisers, however, is paid by the Lender or Product provider as is the current practice in the insurance industry.

This would represent a better business model for Advisers as the level of fee would not be eroded over time by the reducing mortgage, yet inevitably, the level and type of service should remain reasonably constant until arguably the later part of the mortgage term. The client and Adviser should be able to negotiate the Adviser fee for service rendered. It is important that a very consultative process occurs within the industry to enable this more "consumer interest first" process to occur and it is strongly believed that the industry is capable of having that discussion. Ultimately this model would drive up the value proposition to the Consumer.

Trail Commission versus Service Fees

One of the critical areas that makes Mortgage Advisers so vulnerable is the apparent lack of recognition of the good that they do for clients from Lenders. Several attempts to help Advisers build sustainable business models over the past decade have emerged and then been removed. Trail Commissions.

This model proposes that a service fee replaces the trail commission currently provided by Lenders and is passed on to the Consumer. This cannot happen in the current state of the Lending industry.

For this to happen what must evolve is Mortgage Advisers promoting the value they provide to the Consumer in the long term such as;

- Negotiating competitive rates for Consumers
- Re-fixing fixed term facilities with advice to back up the rationale
- Pro-actively reviewing the mortgage with the Consumer annually to ensure its structure remains appropriate to the Consumer's needs.
- Providing tools that help the Consumer's financial literacy capability

The above list is by no means conclusive. If the Mortgage sector was successful in the above, then it is likely we would see a reduction in the level of refinancing, but even more importantly, it transfers the control of the relationship back to the Adviser.

A client with a mortgage of $400,000 would pay approximately $66 per month based on a current trail commission of .20 %. Clearly this warrants further input as to whether this should be a sliding scale of between .10% - .20%.

SECTION 9 – Implementing Change

CHANGING THE TERM “COMMISSION” TO “FEE”

It is difficult to see how the definition of ‘commission’ can change to ‘fee’ given that this paper proposes that the Product Provider is deemed responsible for the payment of this to the Adviser, including the Service Fee.

However, this can very easily be accommodated by simply having existing quotation software that is currently used by Advisers to generate a buyer created invoice between the Adviser and the Product Provider that is paid on the issue of a policy or drawdown of a mortgage. *(See Appendix)*

There will be some additional detail to work through to move towards this model. Discussion with Product Providers to date have indicated that this may not be too difficult. Yes, some Product Providers may have different systems, but I refer to the time when GST came into New Zealand, and all businesses had to make changes to adapt to the new taxation model. This should be fundamentally much less complex.

SECTION 10 – Future proofing sustainability

LONG TERM OUTCOMES – FIVE TO TEN YEARS

This paper proposes a six to twelve-month lead in/consultation process for the Adviser and Product Providers based on a two stage process to adopt the new proposal, depending on how soon Product Providers can adapt current systems and processes, or develop new systems and processes given that Advisers will not overall face any significant drop in revenue.

This will send a strong signal that the industry is capable in taking on responsibility to reinvent itself for the benefit of the consumer. It is noted that some Product providers have indicated the lead in time for introduction ***may*** not be any greater than six months.

In order to encourage a more robust business model for Advisers that focuses on "service", it is possible that after five years of the new model being implemented that discussion to change the responsibility for the ongoing payment of the ***service fee*** may pass over to the client and is charged out by the Adviser on all new business from that date. This will challenge the industry and will certainly challenge consumers in respect that unless Banks follow the same rules.

There is an opportunity for an increase in profitability for the Product Provider should the Service Fee ultimately be passed over to the Consumer.

RISK ANALYSIS

Consumers may feel less likely to apply for insurance through an Adviser if they can achieve it without a fee. The concern here is that it may desensitise Consumers to the value of advice. However, overall at some point in time, this move should be seen as sensible and logical. Alternatively, if the new model is working and has achieved positive outcomes for the Consumer, the Product Provider and Adviser, then one would question the need to do so if there was any chance of Consumers electing to get out of paying a fee for service acknowledging the value of advice. This is clearly not what the profession needs, or for that matter, New Zealand.

Should it ever be agreed by all parties that the Service Fee pass over to the Consumer, the industry needs to trust Advisers to set this as ultimately it will be the client who decides if he/she is happy to pay the fee charged. This will drive higher service standards from Advisers not only to new clients, but also to existing clients, and build better and more sustainable Adviser business models.

It is critical that such savings are passed on to the consumer wherever possible. This will relieve pressure on the less profitable products and enable the Product provider to invest more in development of better and improved products. The reduction in fee/commission being paid under the new model for 'lives with greater health risk' should assist Product Providers to provide some initial premium relief in the sub-standard health risk space. It may be possible for Product providers generally to reduce premiums in some cases.

It is also a risk that some Product Providers may not pass back any savings to Consumers, as some Product Providers do not cross subsidise products. However, with lower costs to ensure lives with greater health risk, and with the removal of 'age related risk versus premium in respect of commission' i.e adviser remuneration for a 50 year old versus a 25 year old being the same, it is a real opportunity for Product Providers to pass back some benefit to New Zealanders.

This all goes a long way to changing the perception of the industry and some of the drivers it has been plagued with over the past two decades or so.

These benefits may also positively impact the 'underinsurance' problem we have in New Zealand as products become more affordable and offer greater value for premium. Advisers will have a change of focus to new business given the robust process in this report directed at replacement business rules.

Product Providers would therefore need to compete on quality of the product, benefits, premiums to the Consumer, ease of doing business between the Adviser and the Product provider. No longer will they be able to compete on and Advisers remuneration, and this is viewed as extremely important to Advisers. As Product Providers are no longer competing on Adviser Remuneration, this will increase equity and quality of advice for the Consumer as the only motive for an Adviser is 'the best interests of the client' and not their own. There may be some 'commercial sensitivity' on this particular point.

OUTCOME: Addresses conflict of interest issues

SECTION 11 - Summary

CLOSING COMMENTS

The content of this Discussion Document is *Confidential* and should only be used for the purpose of engaging in further discussion and opportunity to explore the proposal to ascertain its viability from all aspects. It should be viewed as the foundation to build a long-term sustainable and viable new model for the industry that benefits all parties. It is radically different to any other model implemented overseas, whereby the only way forward has been to attack levels of commission but in essence, still ***retain*** the old commission model which did not address some of the problems it set out to achieve.

To date, feedback received indicates this model can address most, if not all of the concerns that have been raised.

The contributor's to this new model do not agree with the suggestions, recommendations as detailed in the Trowbridge reports and subsequent reports since then. None of those have proposed a new model but only go as far as retaining a commission model with all of its inherited behavioural risk issues that has been in existence since life insurance has been sold to Consumers.

It is time for a new model – this is an opportunity to lead change in a more positive manner than has been implemented overseas.

Clearly assistance and guidance from Advisers, Stakeholders and Product Providers to establish a remuneration/fee based package that encompasses SMART is important;

- Simplicity
- Measureable
- Achievable
- Realistic
- Time framed

This model can address the following issues;

- The perceived level of "Churn" both mortgage and insurance
- Underinsurance to Consumers
- More robust Adviser business models
- Improved profitability for Insurance Product Providers
- Improved Insurance benefits to Consumers
- Improved affordability for Consumers
- Improved value proposition between the Adviser and the Consumer (Insurance Advice)
- Improved value proposition between the Adviser and Consumer (Mortgage Advice)
- Improved transparency for Financial Advisers in respect of remuneration
- One standard remuneration model
- Simpler disclosure for the Consumer
- Greater transparency for the Consumer
- Improved Financial Literacy for Consumers

- Advisers no longer being leveraged against to increase Product provider market share

This will drive;

- Fairness to all parties
- Improved efficiencies
- Better outcomes for the Consumer

Your feedback is valuable and welcome. In the first instance this should be sent to the following;

bruce@planwise.co.nz

darrin@conetworkz.co.nz

Bruce Cortesi

Darrin Franks

APPENDIX

ABC Limited

11 Smiths Road
MOUNT MAUNGANUI
GST NUMBER: 033-888-767

Phone: 07 000 0000
Fax: 07 000 0000

Tax Invoice

Invoice 17/01
Date: May 15, 2018

To:

HISTORY INSURANCE COMPANY LIMITED

Sov GST No: 026-958-113

For:

Consultation services for the implementation of an insurance policy from Sovereign Assurance.

CLIENT NAMES:

Joshua Peter Smith

Marion Diane Smith

DESCRIPTION	SUM ASSURED	GST Content	TOTAL INC
Life Insurance on the life of Joshua Peter Smith	$500,000		$2500
Trauma Insurance on the life of Joshua Peter Smith	$250,000	$163	$1250
Mortgage Protection on the life of Joshua Peter Smith	$28,000	$109	$840
Waiver of Premium Benefit on the life of Joshua Peter Smith		$13	$100
TOTAL FEE ON THE LIFE OF JOSHUA PETER SMITH		**$285**	**$4960**
Life Insurance on the life of Marion Diane Smith	$500,000		$2500
Trauma Insurance on the life of Marion Diane Smith	$250,000	$163	$1250
Mortgage Protection on the life of Marion Diane Smith	$28,000	$109	$840
Waiver of Premium Benefit on the life of Marion Diane Smith		$13	$100
TOTAL FEE ON THE LIFE OF MARION DIANE SMITH		**$285**	**$4960**
		TOTAL	**$9380**

DIRECT CREDIT: 03 0433 098765 00

Please pay within 24 hours of the policy documents being issued to the client.