Replacement business - what's the issue?

Tony Vidler | Strictly Business | 06 May 2013

The vexed issue of replacement business is bubbling up again it seems, or as was once famously said: "It is déjà vu all over again". So here's the big burning question - what's the issue, really?

Clearly, there are strongly held views across the industry, with as many fervently in the Don't-Do-It camp as there are in the Let's-Go-To-Town camp, it seems. It is an issue that polarises opinion and results in name-calling and character slurs being cast about in heated exchanges. Anecdotally, I hear stories suggesting that a high proportion of the complaints against financial advisers in the new regulatory regime are lodged by other advisers, often as a result of business being replaced.

Any commercial issue that carries both a (relatively) high financial incentive together with little independent oversight creates an environment that is ripe for aberrant behaviour. The thing that separates good replacement business and bad replacement business is the adviser's ethics.

Before considering ethical questions though - is there a business case for replacement business?

In general terms (and I KNOW there are exceptions), engaging in replacement business is easier than creating entirely new accounts and new business. So the return is, in relative terms, higher. There is also less expense in conducting this business as there is virtually no marketing budget required to obtain it. So, commercially it makes sense to pursue that work from an adviser's perspective.

As for the products themselves... well, it would be fair to say that there are many legacy products still in place in the market that have not been upgraded with better definitions and benefits by the product manufacturers. There IS often a significant difference in today's new policy coverage than is available at claim time under the 1999 version offered by the same insurer. More and more insurers are moving down the path though of applying retrospective enhancements to their policies, which is a significant improvement for consumers and nullifies many of the reasons for replacing old for new.

Having said that, there remains a large range of products where there is massive variation in terms and conditions within what appears to be the same basic benefit. There are insurers providing policies with stringent limitations and reduced core benefits at similar price points to insurers providing far more comprehensive and beneficial policies. Faced with such quality differences for negligible price differential, why wouldn't an informed consumer or a caring adviser change products?

And what of compliance and best practice expectations? There is clearly a strong compulsion contained within the Code of Professional Conduct for a professional adviser to effectively begin every engagement with a clean slate. Find out the facts NOW... establish the clients needs at THIS point in time... research the viable choices available NOW... recommend what is appropriate for the CLIENT in light of that.

And, there is a huge issue right there. It is about recommending what is appropriate for the client in light of the information that is known now, about the future needs that can be identified now, taking into account the choices that are available for them now.

This obligation essentially pitches adviser against product supplier. THAT is the real issue in replacement business. There is no alignment of interests between consumers, advisers and product suppliers - they are pitched against each other with different primary interests.

The product supplier has a strong vested interest in maintaining the existing policy. The longer it goes, the more profitable it is. In general terms, there is also less risk (or potential claims events) in older policies and they are often for lower sums insured - so there is less contingent liability on the books with older policies for an insurer. Because of these two factors, there is also less pricing pressure on those policies, making it easier to maintain profitability and in force business. Don't think I am suggesting life insurers do not care about their clients, or that they do not make efforts to upgrade and better protect their clients by moving them to better policies. What life insurers do try to do is upgrade their clients to better products without incurring the marketing and distribution costs all over again for what is essentially the same premium income staying on their books.

Advisers want to be paid for doing the work again - even if it is less work than it was the first time around. (That is debatable though, isn't it? I would suggest that there is more work in doing replacement business today than there was in doing a brand new case 10 years ago.).

Consumers don't care who they are with in the main. They just want the least hassle and the least paperwork, and the highest degree of certainty that this insurance stuff actually performs at claim time without sending them broke in the meantime.

There are many many advisers who engage in replacement business to the highest ethical standards. They only do so when it is clearly to the client's advantage. It is their personal ethics that prevent the aberrant behaviour of wholesale replacement plunder.

Perhaps the time is right to ignite a discussion about how to align EVERY stakeholders interests in this respect, though, to ensure those who are still in plundering mode are contained and those who are providing best practice and objective professional advice can do so without fear of persecution.

So, how can we take into account the consumers desire to obtain best coverage with least hassle or risk of non-disclosure; the advisers desire to provide objective advice based on current facts and choices while being paid to do so; and, ensure that product suppliers are given a fair chance at retaining the clients they have spent significant sums to acquire?

I think the solution must be delivered through intervention. The industry itself with its many competing interests and squabbles for minor percentage points of market share movements each quarter cannot agree on what time lunch should start. It has been done overseas (e.g. South Africa). I remember Ron Flood as LBA President campaigning strongly some years ago for a scheme whereby any replacement business automatically only got paid yearly ongoing renewals (for example, 15% per annum, or whatever the prevailing rate is) with no up-front commissions or bonuses or incentives involved. His key point was to begin to align the interests by removing the conflicting interests.

Either the market authority, or the body that represents all product suppliers, or the collective adviser representatives must move for such a change. It cannot be done otherwise. Align the interests of each of the stakeholders and the issue can be resolved for good.

Footnote

Back in 2008, a few years before the shape of our regulated environment was even known, Garth Clarricoats and I wrote a short best practice guide on the subject for IFA members. As an aside, to head off any assertions of breach of confidentiality, this was not commissioned work for the IFA. It was simply two CLU practitioners writing a guide for the benefit of other risk-based advisers that was donated to the IFA. Interestingly, I reviewed it again recently and it seems to remain valid in light of the Code of Professional Conduct and today's best practice advice standards. It can be viewed here: http://www.strictlybiz.co.nz/tools2/#replacement

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