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# Behavioural Finance of Risk Insurance

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2022

# Agenda

1. Financial Planner and Adviser Code of Ethics 2019
2. Behavioural Finance Essentials
3. Learning and Decision Making
4. The Life Insurance Journey
5. Purchase and Lapse Decisions
6. Attributes of a Trusted Adviser
7. Summary

# Code of ethics

# Financial Planners and Advisers Code of Ethics 2019 – commenced 1 January 2020

## Standards of

### Ethical behaviour

#### Standard 1

You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent.

#### Standard 2

You must act with integrity and in the best interests of each of your clients.

#### Standard 3

You must not advise, refer or act in any other manner where you have a conflict of interest or duty.

## Standards of

### Client care

#### Standard 4

You may act for a client only with the client's free, prior and informed consent. If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences.

#### Standard 5

All advice and financial product recommendations that you give to a client must be in the best interests of the client and appropriate to the client's individual circumstances.

You must be satisfied that the client understands your advice, and the benefits, costs and risks of the financial products that you recommend, and you must have reasonable grounds to be satisfied.

#### Standard 6

You must take into account the broad effects arising from the client acting on your advice and actively consider the clients broader, long-term interests and likely circumstances.

## Standards of

### Quality process

#### Standard 7

The client must give free, prior and informed consent to all benefits you and your principal will receive in connection with acting for the client, including any fees for services that may be charged. If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences.

Except where expressly permitted by the Corporations Act 2001, you may not receive any benefits, in connection with acting for a client, that derive from a third party other than your principal.

You must satisfy yourself that any fees and charges that the client must pay to you or your principal, and any benefits that you or your principal receive, in connection with acting for the client are fair and reasonable, and represent value for money for the client.

#### Standard 8

You must ensure that your records of clients, including former clients, are kept in a form that is complete and accurate.

#### Standard 9

All advice you give, and all products you recommend, to a client must be offered in good faith and with competence and be neither misleading nor deceptive.

## Standards of

### Professional commitment

#### Standard 10

You must develop, maintain and apply a high level of relevant knowledge and skills.

#### Standard 11

You must cooperate with ASIC and monitoring bodies in any investigation of a breach or potential breach of this Code.

#### Standard 12

Individually and in cooperation with peers, you must uphold and promote the ethical standards of the profession, and hold each other accountable for the protection of the public interest.

### Our values

A relevant provider must always act to realise and promote the values of:

- Trustworthiness
- Competence
- Honesty
- Fairness
- Diligence

A relevant provider is defined in the Corporations Act 2001 (s 910A) as an individual authorised to provide personal advice to retail clients, ..... in relation to relevant financial products.

# Financial Planners and Advisers Code of Ethics 2019

<b>Standard 5</b>	<ul style="list-style-type: none"><li>• All advice and financial product recommendations that you give to a client must be in the best interests of the client and appropriate to the client's individual circumstances.</li><li>• You must be satisfied that the client understands your advice, and the benefits, costs and risks of the financial products that you recommend, and you must have reasonable grounds to be satisfied.</li></ul>
<b>Standard 6</b>	<ul style="list-style-type: none"><li>• You must take into account the broad effects arising from the client acting on your advice and actively consider the client's broader, long-term interests and likely circumstances.</li></ul>
<b>Standard 9</b>	<ul style="list-style-type: none"><li>• All advice you give, and all products you recommend, to a client must be offered in good faith and with competence and be neither misleading nor deceptive.</li></ul>

# Behavioural finance essentials

# Founders of behavioural finance

- Richard Thaler (Nobel Prize in Economics – 2017)
- Daniel Kahneman (Nobel Prize in Economics – 2002)
- Dan Ariely – Qapital & Lemonade & Kayma.
- Amos Tversky
  - Judgment under Uncertainty: Heuristics and Biases (1974) – with Kahneman
  - Prospect Theory: An Analysis of Decision under Risk (1979) – with Kahneman



# Heuristics: Mental shortcuts

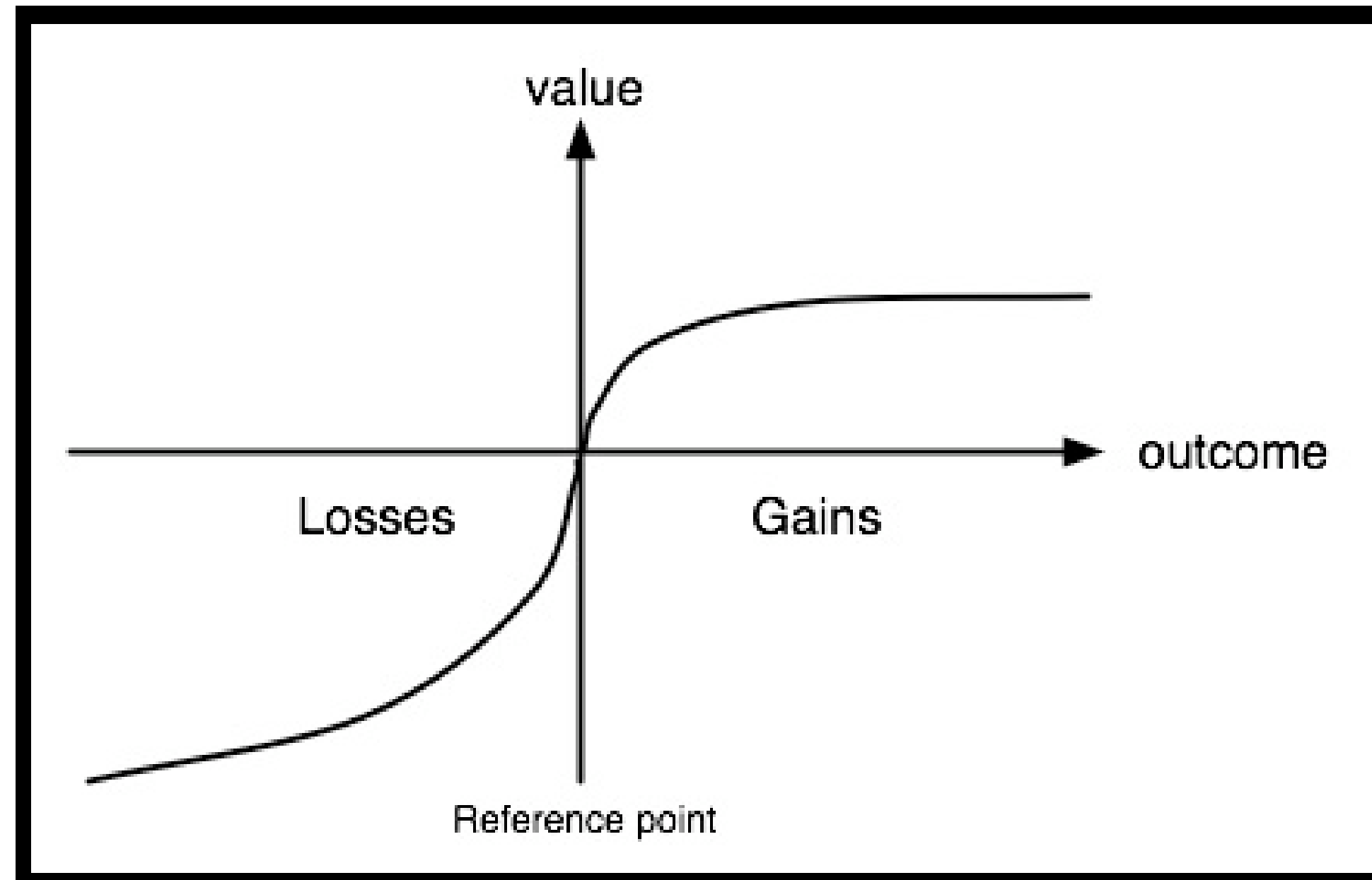
1. Mental accounting – people allocate money for specific purposes.
2. Herd behaviour – people tend to mimic the actions of the majority of the herd.
3. Emotional gap – people making decisions based upon extreme emotions or strain (anxiety, anger, fear, or excitement).
4. Anchoring – spending is based upon a budget or specific utility.
5. Self-attribution – choices based upon overconfidence in ones own knowledge or skill.



# Behavioural Finance: Biases

1. Confirmation bias – accepting information that reinforces their existing beliefs.
2. Recency bias – belief that a recent event is more likely to occur again.
3. Loss aversion – people place a higher value on avoiding a loss, rather than making a similar gain
4. Endowment effect – people do not like letting go of something they already own.
5. Sunk cost fallacy – keep something because you have paid lots of money, and seeking a return.
6. Familiarity bias – prefer something they already know versus something new.
7. Status quo bias – maintain the current state of affairs.

# Utility Function in Prospect Theory: Loss Aversion



Source: Kahneman, Daniel; Tversky, Amos (1979). "Prospect Theory: An Analysis of Decision under Risk". *Econometrica*.

# Prospect Theory

- Risk aversion: People prefer to avoid losses.
- People assign higher weights to low probability events – this is attractive for insurance.

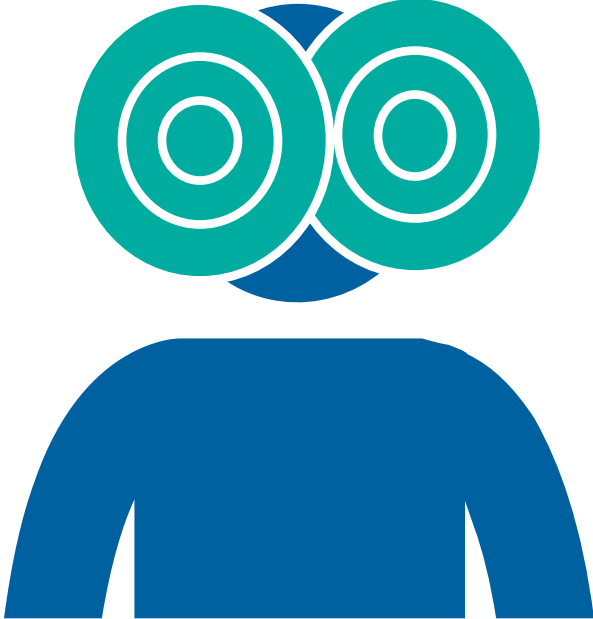




# Learning and Decision Making

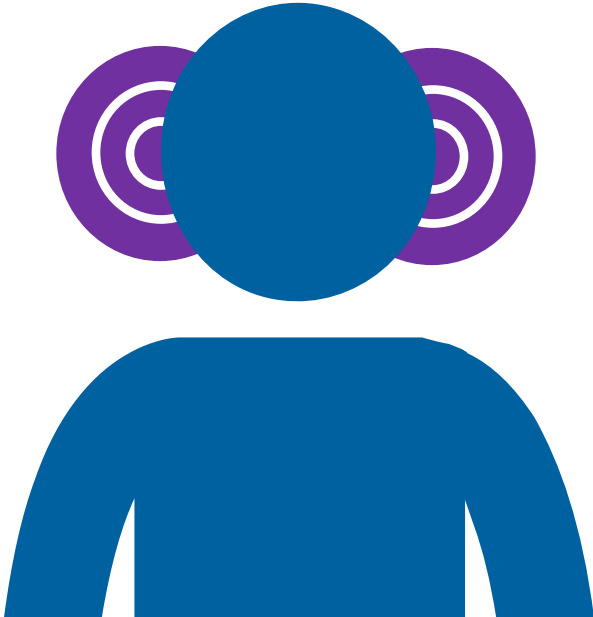
# How clients learn

SEE



**Visual**

HEAR



**Audio**

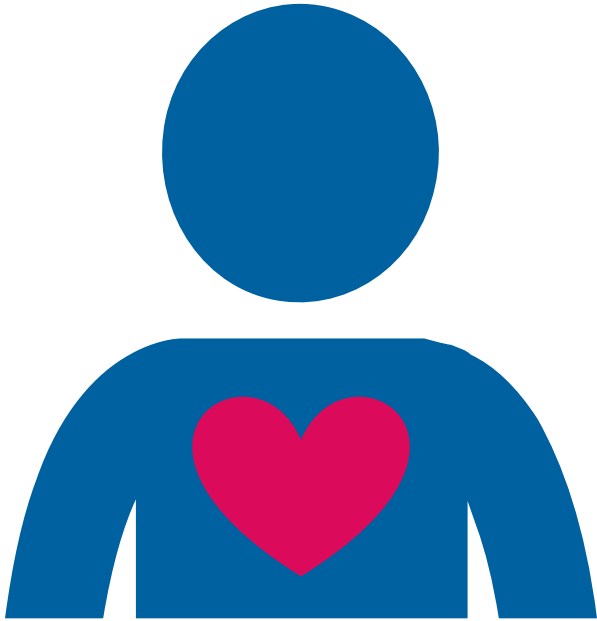
DO



**Kinaesthetic**

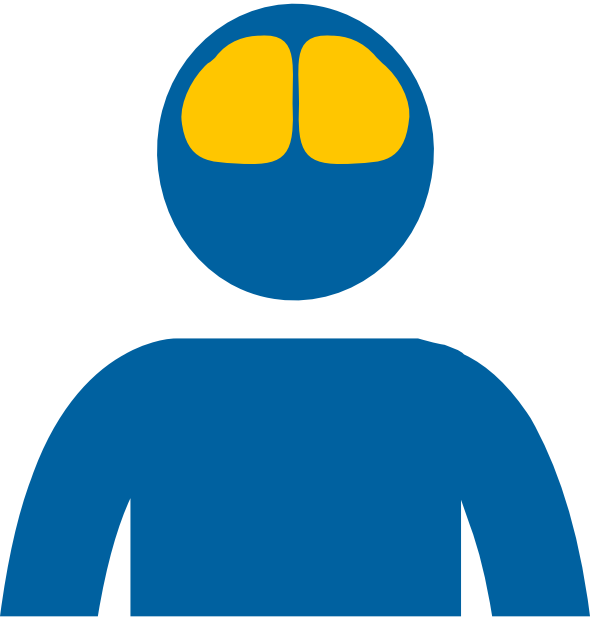
# How clients make purchasing decisions

HEART



**Emotional –  
Feeling**

HEAD



**Analytical –  
Facts and figures**

GUT/SOUL



**Somatic –  
Trust**

# The buyer journey

Need recognition



Information search



Evaluation of alternatives



Purchase decision



Post purchase behaviour





## Question #1

What are the three (3) primary ways people process information (learn)?

- A. Emotional, Analytical, and Somatic.
- B. Audio, Visual, and Kinaesthetic.
- C. Head, Heart, and Gut.
- D. Computer, Podcast, and Artificial Intelligence (AI).



# The Life Insurance Journey

We all have a natural urge to protect the things that are most important to us. It's in all of us – instinctive, immediate and often unconscious.



# The role of life insurance

## Principal purpose of insurance

- Eliminate debt
- Create an income stream.

## CIMER

- Clean Up: Funeral expenses, credit cards, personal loans, wills and estates, etc.
- Income: Future income to support family.
- Mortgage: Payout what is owed to the bank.
- Education: Ensure children can afford secondary and tertiary education.
- Retirement: Provide for surviving spouse.

# How to calculate the sum insured

- Calculate all assets and liabilities
- Calculate income and outgoings
- Do a budget

Life insurance premiums are based upon a number of factors:

- Age, health, occupation
- Sum insured
- Types of policies (Life Cover, TPD Cover, Trauma Cover, and Income Cover)



# Purchase and lapse decisions

# Clients' views of life insurance

## Reasons to purchase


- Bought house/new mortgage
- Pregnant or recently had children
- Adviser recommended
- Starting a business
- Health scare
- Friend advised me



# Clients' views of life insurance

## Reasons to Lapse

- No longer relevant to circumstances
- Unaffordable
- Loan reduces
- No engagement from insurance company
- No engagement from financial adviser



Customers want  
**infrequent, personal**  
and **tailored** contact  
NOT frequent and  
generic.



# The statistics – it won't happen to me!

- 70% chance of surviving cancer for 5 years
- In 2022 – 162,163 new cases of cancer were diagnosed in Australia
- 2 in 5 people (43%) will be diagnosed with cancer by the age of 85<sup>1</sup>
- 27% of cancer patients are between the ages of 20-59<sup>2</sup>
- Cardio Vascular disease effects one in sixteen Australians
- There are 58,700 heart attacks per year which is equal to 1 every 9 minutes
- Around 38,600 strokes per year, around 1 in every 14 minutes<sup>3</sup>
- From the start of this presentation today until the end there would have 9 people in Australia that would have had a heart attack or stroke

1. <https://www.canceraustralia.gov.au/impacted-cancer/what-cancer/cancer-australia-statistics> - accessed 5 September 2022

2. <https://www.aihw.gov.au/getmedia/0ea708eb-dd6e-4499-9080-1cc7b5990e64/aihw-can-144.pdf.aspx?inline=true> – accessed 5 September 2022

3. <https://www.aihw.gov.au/reports/heart-stroke-vascular-diseases/hsvd-facts/contents/about> - accessed 5 September 2022

# APRA claims statistics

Higher proportion of admitted claims:

- Death - 97% for Advised clients v 90% for Non-Advised clients.
- TPD – 83% for Advised clients v 67% for Non-Advised clients.
- Income Protection – 95% for Advised clients v 91% for Non-Advised clients.

Life Insurance Claims and Disputes Statistics - December 2021 (issued 19 April 2022)  
<https://www.apra.gov.au/life-insurance-claims-and-disputes-statistics>



# Insurance objectives

It is the process of identification and prioritisation of needs and objectives that is the most important aspect of financial advice for consumers. It is a key reason why consumers look for financial advice. (Source: ASIC Report 413 - Review of retail life insurance advice).

Specific

Measurable

Prioritised

Avoid generic terms such as “protect family”

- Debt reduction/repayment.
- Emergency/cash funds.
- Medical expenses or home renovation expenses.
- Education or business-related expenses.
- A lump sum amount to produce a level of regular income for financial dependants for a period of time.

# Explore the personal situation

Good advice is founded on a solid strategy that requires identification of the client's relevant personal situation and needs (source: ASIC Report 413 - Review of retail life insurance advice).

Ensure you investigate with relevance to insurance:

- Relationship status and family circumstances
- Foreseen changes to their personal or financial position
- Existing insurance arrangements including superannuation fund
- Health issues
- The relative priority of insurance needs
- Willingness and capacity to pay premiums.

# Explore insurance vs self insurance

Good advice recognises that insurance is not a mandatory outcome of having financial exposure.

Explore alternatives such as:

- leave entitlements, employee benefits and liquid assets;
- extended family support or to downsize their home to access capital;
- returning to work or increasing working hours; and
- entitlements to social security and/or workers compensation.



# Explore insurance vs self insurance

- Savings or sinking fund
- Line of credit or loan from lending institution
- Government (Centrelink – from 20 March 2023):
  - JobSeeker Payment - **\$693.10 per fortnight**; \$18,020.60 per annum (single rate)
  - Disability Support Pension - **\$1,064.00 per fortnight** (with Pension Supplement and Energy Supplement); \$27,664.00 per annum (single rate).
- Charity
- Sell existing assets
- Parents or friends
- Winning a lottery
- Assume it will never happen (not recommended!)

Australian Government – Services Australia - Centrelink Payments (as at 20/03/2023)

<https://www.servicesaustralia.gov.au/how-much-jobseeker-payment-you-can-get?context=51411>

<https://www.servicesaustralia.gov.au/payment-rates-for-disability-support-pension?context=22276>

## Question #2

What are the 3 most significant Standards under the Financial Planners and Advisers Code of Ethics 2019, when considering Life Insurance?

- A. Standards 1, 2, & 3.
- B. Standards 4, 5, & 7.
- C. Standards 10, 11, & 12.
- D. Standards 5, 6, & 9.



# Beware replacement advice!

## The advice should clearly explain

- Why the new product is better than the old product
- What specific features are better and what has been lost, improved policy terms should be spelled out

## Duty of Disclosure/Duty of care not to make a misrepresentation s29(3)

- Significant risk to planner and insured
- Re-commencement of disclosure period and obligations

## SIS Act changes July 2014

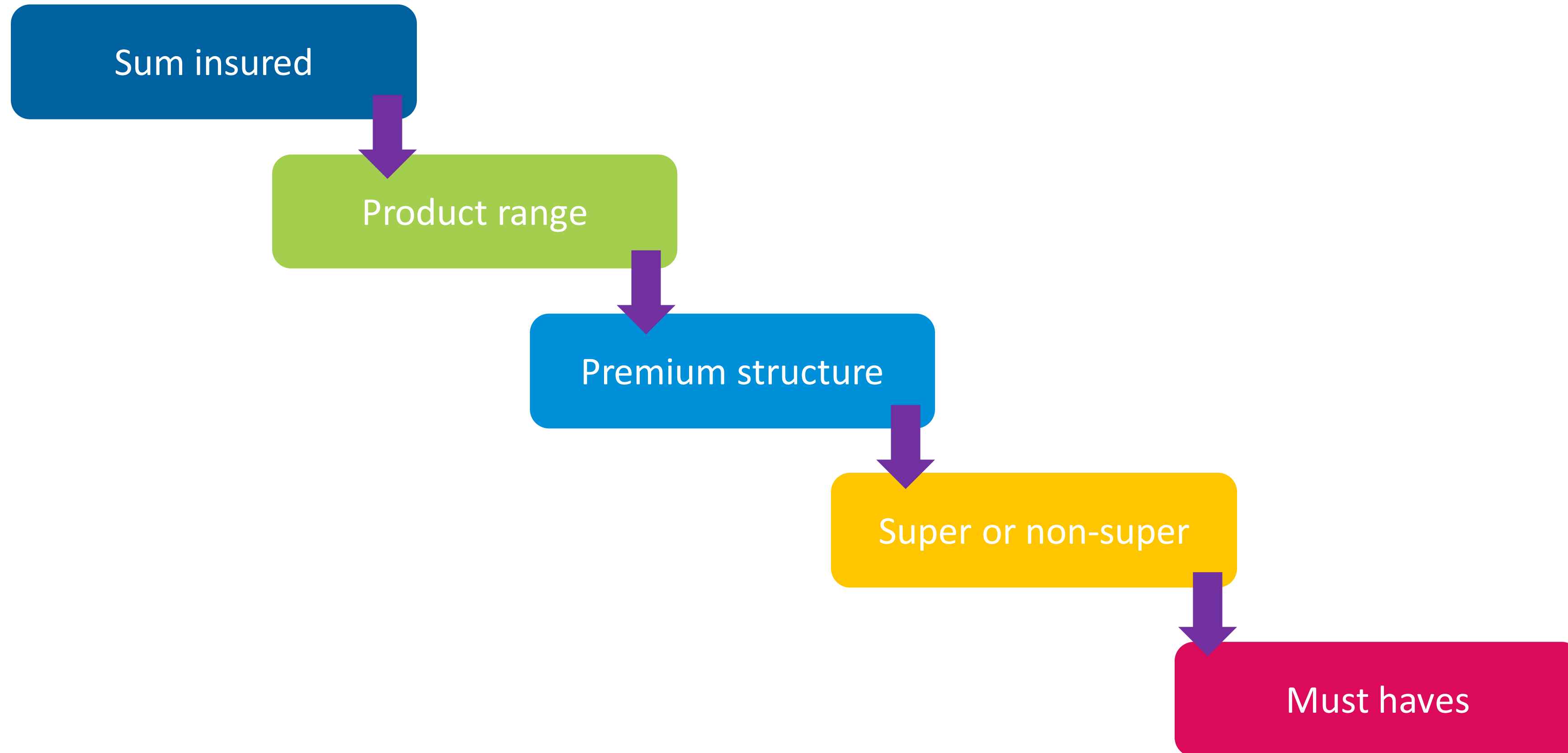
- Insurance in super must be consistent with the condition of release
- Existing arrangements can be maintained
- Replacement will result in loss of benefits

## APRA IDII measures

- Agreed value insurance now longer available
- Existing arrangements can be maintained
- Replacement will result in loss of agreed value, reduction in replacement ratio (70%)



# Insurance advice priorities



# Insurance advice priorities

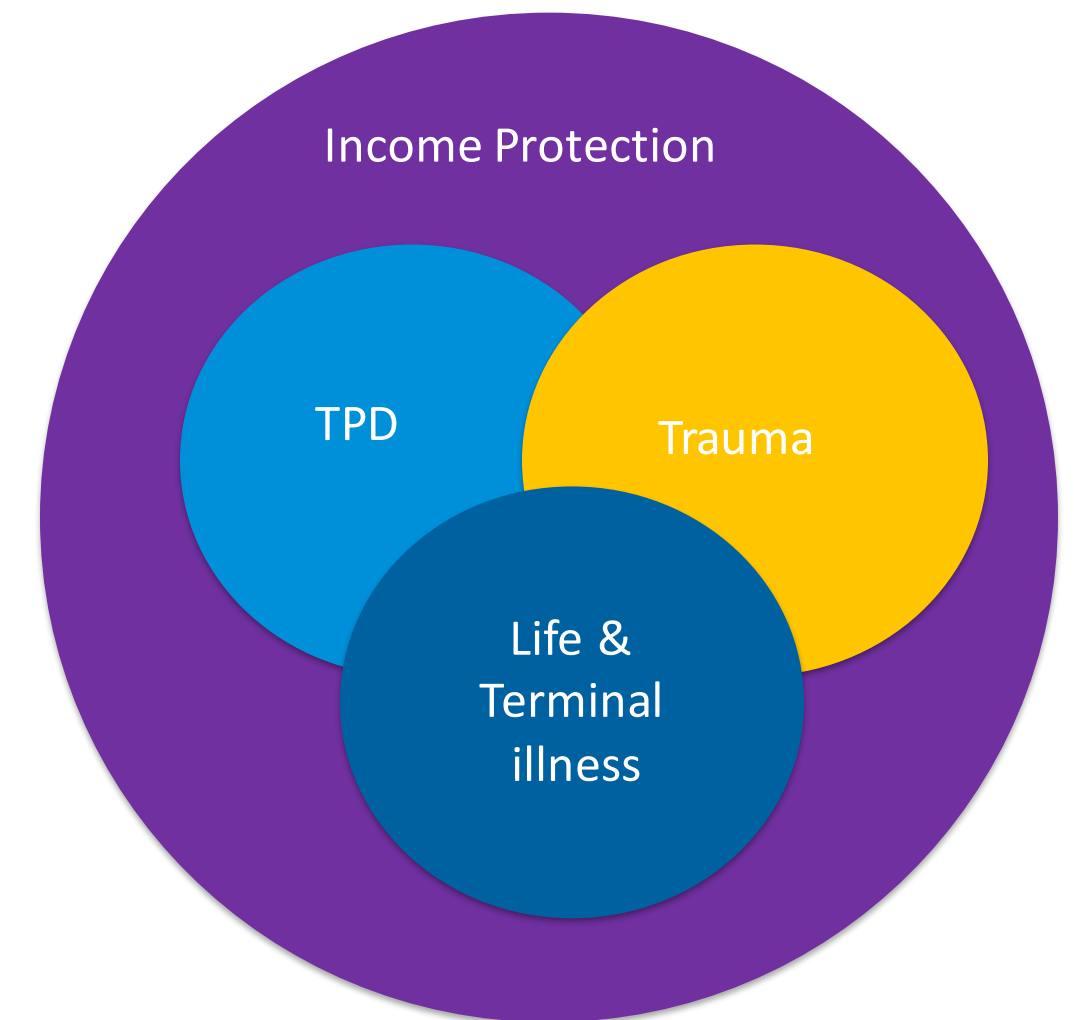
## Sum insured

- Objective: Determine the clients' unfunded liabilities and obtain a sum insured to meet these liabilities.
- What use is the “best” product if in the event of a claim the family can't pay the mortgage?
- The sum insured needs to meet the financial consequences of the event.
- “Helping set an appropriate sum insured, balancing the competing priorities of underinsurance versus affordability” (ASIC Report 413 - Review of retail life insurance advice).

# Insurance advice priorities

## Product range

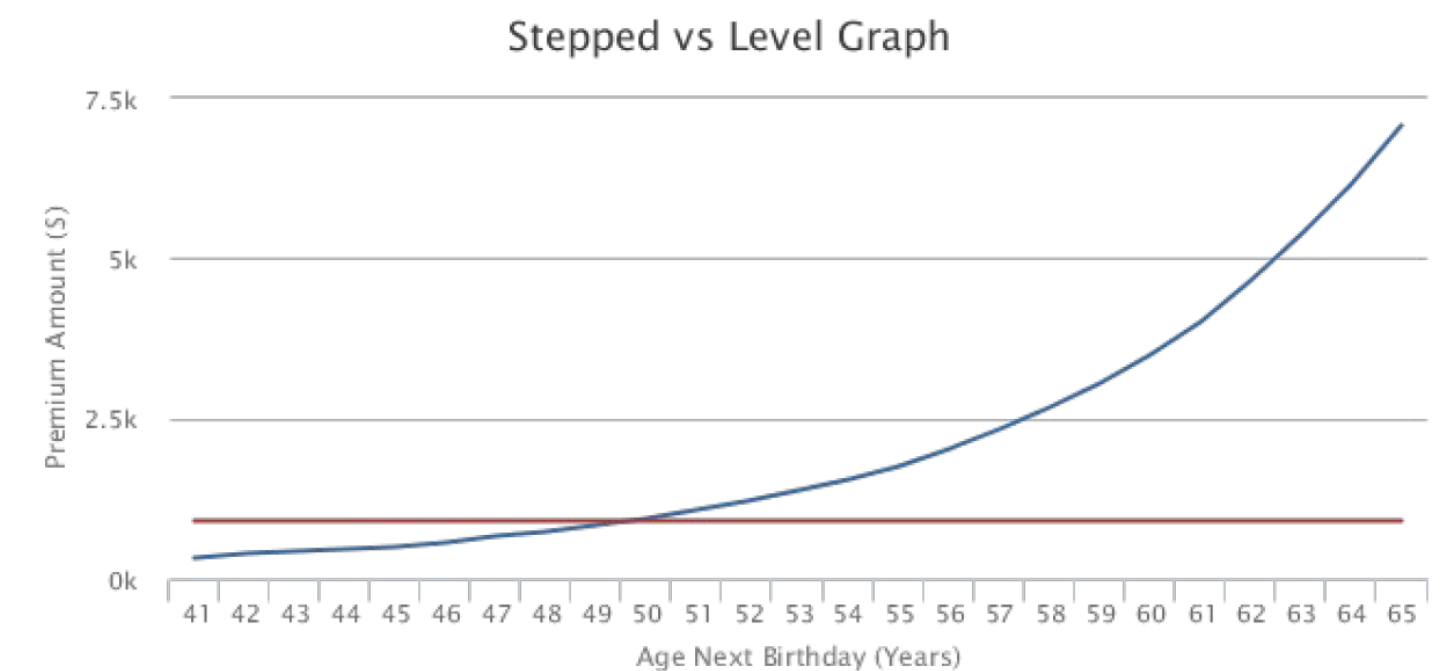
- Objective: Achieve the balance of product(s) required to cover the potential risks that the client is exposed to.
- Life, TPD, Trauma and Income protection have the potential to “crossover” in the event of a claim, but each product has its own purpose.
- Don't bias of one product over another
- Pragmatic decisions may have to be made based on underwriting and affordability, but ideally a “holistic” solution should be recommended.



# Insurance advice priorities

## Premium structure

- Objective: Design a premium basis and product structure that will enable the client to continue to be able to afford their insurance for the expected duration of their need.
- Helping the client evaluate the merits of stepped versus level premiums relative to the amount of time the client may expect to hold insurance— for example, until debts are repaid, children are adults, or the client transitions to retirement (ASIC Report 413 - Review of retail life insurance advice)
- The adviser failed to adequately consider the affordability or sustainability of paying the insurance premium. In balancing the insurance objective against the retirement savings objective the advice sacrificed one for the other (ASIC Report 413 - Review of retail life insurance advice).



# Insurance advice priorities

## Super or non-super

- Objective: What is the optimal structure to hold insurance based on cost, cash-flow, quality of cover, tax treatment of premiums and proceeds, impact upon retirement and trustee obligations.
- Paying for insurance from superannuation is an entirely viable and appropriate strategy. However, the true costs and effects of this approach should be discussed with clients.
  - relevant taxation issues;
  - binding or non-binding death benefit nominations and the need to update those nominations as circumstances change; and
  - the merit of making concessional or non-concessional contributions to the client's superannuation fund to mitigate the effect of insurance premiums on retirement benefits. (ASIC Report 413 - Review of retail life insurance advice).

# Insurance advice priorities

## Must haves

- Objective: Establish a strong and demonstrable rationale for the product recommendation.
- Satisfy “know my product” and “know my client”
- The most fundamental of questions: “what is it and why?”
- Its not a research score: where software has been used to rate policies, advisers should spell out why a particular product has a higher rating. (ASIC Report 413 - Review of retail life insurance advice).
- Testing the value of optional extras against the client’s ability to sustain the insurance over time by prioritising the essential and the non-essential. (ASIC Report 413 - Review of retail life insurance advice).



# Attributes of a Trusted Adviser

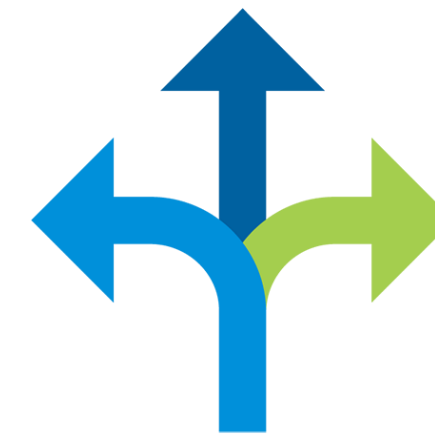
# Attributes of a trusted adviser



**1.**  
**Engage**  
Listen & understand



**2.**  
**Examine**  
Clarify the need



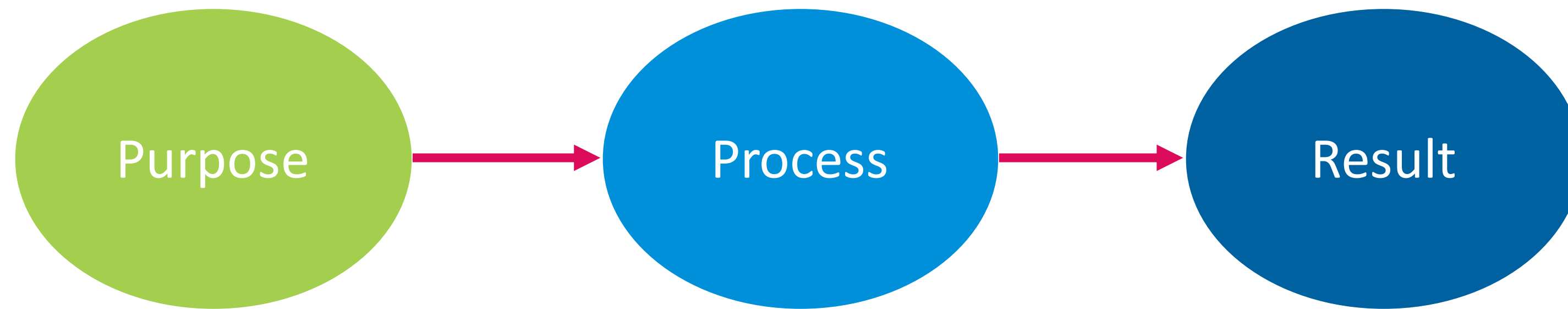
**3.**  
**Explore**  
Guidance



# Attributes of a trusted adviser

- Clients share their intimate personal or family issues with you
- Clients value your input in **ALL** their financial and lifestyle decisions
- Assist clients to better understand their **VALUES**
- Advisers invest the time to truly understand their clients' values, needs, financial and lifestyle objectives
- Financial products are never discussed in the first meeting
- Every one of your clients is an active promoter of your business

# The Client Value Proposition



Source: Sinek, S. (2011), Start With Why: How Great Leaders Inspire Everyone to Take Action. Penguin Group, New York, New York.

# Client Value Proposition: Strategy on a page

	Death Cover	Permanent Disablement	Critical Illness	Disability Income
Ownership	Employer	Self-Owned	Self-Owned	Self-Owned
Considerations and Assumptions	Estate planning, Tax	Pay for full time nursing care	Family history of cancer	Tax deduction for premium
Premium	Stepped	Stepped	Level	Level
Strategy – Couple with no children	Pay off mortgage, funeral	\$100,000 for home modification	\$125,000 for medical expenses	70% income replacement

## Question #3

What are the three (3) principal attributes of a trusted adviser?

- A. Listen & Understand, Clarify the Need, and Provide Guidance.
- B. Audio, Visual, and Kinaesthetic.
- C. Insurance specialist, Superannuation expert, and Investment guru.
- D. Big house, Expensive car, and Tailored business attire.

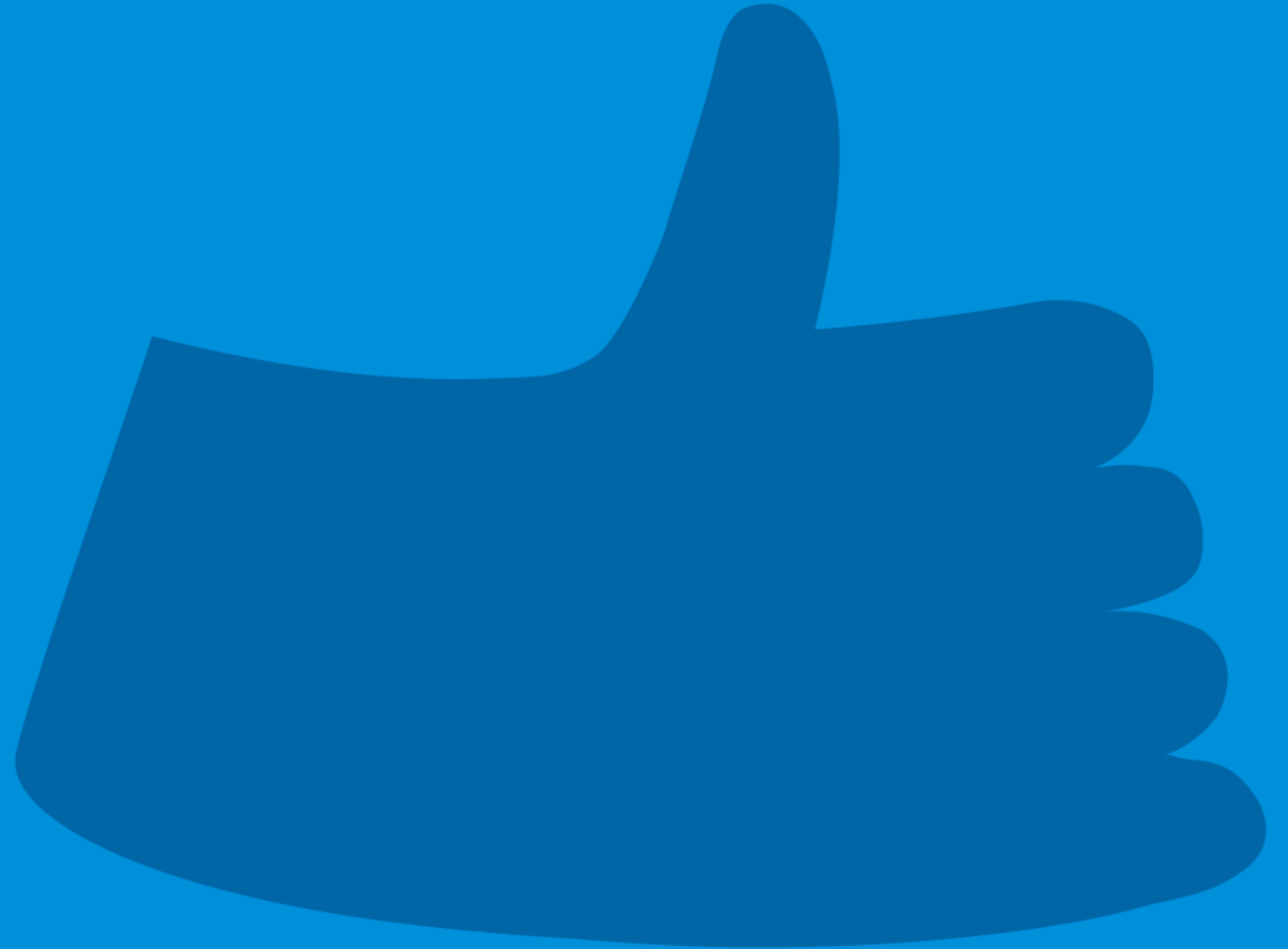


# Summary

# Summary

1. Clients learn by:
  - hearing, seeing and doing
2. Clients make purchasing decisions by:
  - emotion (heart), logic (head), and feeling (gut/somatic)
3. Differentiate and Articulate –
  - purpose, actions and results
4. Appropriate cover and sum insured is more important than best ratings

Thank you





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