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The Straits Times
www.straitstimes.com
Published on Jan 29, 2013

Reining in unethical insurance practices

By Magdalen Ng Eye on the Economy

SINGAPORE'S commission-based system for insurance agents has often been cited as the main cause of unethical selling of insurance products.

The criticism goes that agents push particular products to land higher commissions for themselves, rather than recommend those suitable for the consumer.

This longstanding problem was one reason behind the Monetary Authority of Singapore's (MAS) launch of a comprehensive review of the industry last year.

MAS managing director Ravi Menon gave the framework for the review at the Life Insurance Association's 50th Gala Dinner last March.

He outlined five key areas of review: to protect and benefit the consumer; raise the competence of financial advisory representatives; raise the quality of advisory firms; make financial advice a dedicated service; lower distribution costs; and promote a culture of fair dealing.

As part of the review, he proposed a switch from the existing commission-based system to a fee-based one. Agents would be paid a fee for the advice they give, not by commissions for selling particular products. Consumers would pay this fee regardless of which product they bought, or even if they bought none. Agents then wouldn't push products which earned them higher commissions, but would recommend products that are genuinely in consumers' interests.

A review committee comprising regulators, industry practitioners, academics and consumer associations was convened, to come up with suggestions on how to improve the industry.

During the eight months of deliberation by the panel, financial advisers waited with bated breath, especially on the issue of whether their remuneration structure would be shifted to a fee-based one - a shift that most believed would affect their rice bowls.

Many must have been relieved when the panel revealed their recommendations a week and a half ago. The panel concluded that Singapore is not ready for a fee-based advisory now.

The panel essentially suggested retaining the status quo. However it proposed improvements to the commission-based system, such as tweaks to limit the amount of commission received in the first year, and spreading the remaining commission over a longer period of time.

Those who support the move towards a fee-based scheme for the agents attribute the backtracking on this issue to the huge resistance put up by the big boys in the industry.

Almost every major insurer - Great Eastern, Manulife, Prudential and AIA - stated their views opposing the fee-based structure.

Financial advisers were also up in arms, meeting regulators behind closed doors to state their cases, and even holding a media event to get their point across.

Has the opportunity to reform the industry been lost?

Well, the answer is yes and no.

The reasons why the system needs to be fixed have been highlighted many times.

A 2002 study on the effect of commission-based remuneration on financial advice in Britain, submitted to the UK Financial Services Authority, found that financial advisers did exhibit significant commission bias - recommending products or providers that pay them the largest commissions, for a small number of single-premium products.

Commission bias is bad for consumers, since unsuitable products are recommended.

But a fee-based system is not a cure-all either. Bias can also occur with a fee-based remuneration system. For example, advisers could take more time in delivering their advice if they are being paid on an hourly rate. Or, if they are paid based on the size of the portfolio, clients with less money may be underserved.

Currently, Britain and Australia are two key jurisdictions that have gone ahead with a remuneration model, but they have retained the commission structure for selected protection-based products.

In Britain, it is also too early to tell how successful the change is as the system came into effect only this month.

One difference between the two jurisdictions and Singapore is that Britain and Australia offer free basic health care, meaning that there is very limited demand for basic health insurance there.

In fact, one of the proposals by the panel is similar to introducing a fee-based system but for only a limited range of products.

The proposals involve setting up a "direct channel" through which a customer can buy certain products like health and term insurance.

These customers will not have to pay commissions. They can approach the insurer at a customer service centre and pay a nominal fee on top of the cost of the plan.

Mr Lee Chuan Teck, chairman of the review panel and assistant managing director at the MAS, said that could be one way to gauge the public's response to such a model.

In addressing the issue of unethical selling, the solution should not perhaps be seen as a stark choice between fees and commission.

It could be addressed, for example, through changing the commission-based structure.

Imposing a flat commission rate on all products, be it investment or insurance, will remove any incentive to favour one product over the other.

Another option is to pay financial advisers based not only on their sales, but also on the quality of advice and the suitability of products that they recommend.

Banks have employed this "balanced scorecard" approach mostly since 2009, to cut down on misselling.

The problem with this approach is the challenge facing insurers and financial advisory firms to put in place robust ways of conducting these post-sales checks on their advisers.

But in the end, while regulators can put in place many measures to police the financial advisory industry, the consumer too has to share the responsibility when it comes to protecting his own interest. After all, no matter what the adviser does, he cannot force the consumer to sign his name on the dotted line.

Consumers can guard against errant financial advisers by equipping themselves with the relevant knowledge and background information before accepting financial advice.

It is also vital for consumers to understand their own needs and objectives, so they can evaluate a product's suitability.

Before committing to any product, the consumer may seek out a second opinion, or discuss with family and trusted friends. Even after taking up a policy, there are now free-look periods, during which they can back out.

The onerous burden of consumer protection should not fall on regulator or financial advisers alone, especially if consumers cannot care less.

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