Risk Profiling for Insurance Advice

A presentation to:
Centrepoint Alliance

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Session Synopsis

Personal risk appetite is highly individual and will be a major influence on the types and amounts of insurance that will be appropriate for any given client.

We delve into methods to help advisers pinpoint this for their clients to deliver tailored risk mitigation solutions.

Learning Outcomes

1) Identify different client attitudes to risk

2) Understand the questions to ask a client to pinpoint their risk profile

3) Ability to interpret the information to deliver a personalised risk mitigation strategy to client

Agenda

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1. What is Risk?
2. Relationship to traditional Risk Profiling
3. Elements of Profiling
4. Trade-Offs
5. Example Scenarios

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How do we Define Risk?

Defining Risk in the Context of Financial Planning

Risk: A Situation involving exposure to Danger

Dangers in a FP context could mean a number of things

Loss of Income, debt exposure, financial dependants, retirement savings

Intangible factors such as impact to broader wellbeing are also important to consider

Traditional Risk Profiling

Poll 1

How does Risk Profiling help you in giving Investment Advice?

A) Helps me understand a clients attitudes & values towards risk

B) Helps me illustrate to clients data behind our decisions

C) Gives me a clear link to the appropriate solution from our investment philosophy

D) Is a great compliance tool

Risk Profiling & Investment Decisions

How has financial advice utilized Risk Profiling?

Ability to Take Risk

An investor’s ability to take risk includes the investor’s time horizon, potential need for liquidity, and risk capacity.

These factors will determine the investor’s financial ability to withstand declines in portfolio values. The ability to take risk can often be a limiting factor when considering an investor’s need for risk to meet corresponding goals

Behavioral Loss Tolerance

An investor’s behavioral loss tolerance can upset the most carefully devised quantitative portfolio strategy.

Best practice is to use psychometric tools (often questionnaires) that have demonstrated reliability and validity in predicting an investor’s emotional and behavioral tendencies around loss of portfolio value and investing discipline

Parallels to Personal Insurance Advice

The similarities are numerous:

At it's core choosing to take out an insurance policy is due to a lack of tolerance for that potential loss/consequence.

Compliance requirements have increased making it important to have transparent documentation of how a strategy was arrived at.

Elements such as time horizon and liquidity/cash flow are equally important for insurance in the context of a long term financial plan.

A collaborative process is much more likely to have the client understand why they are getting what they are getting – an important ethical consideration.

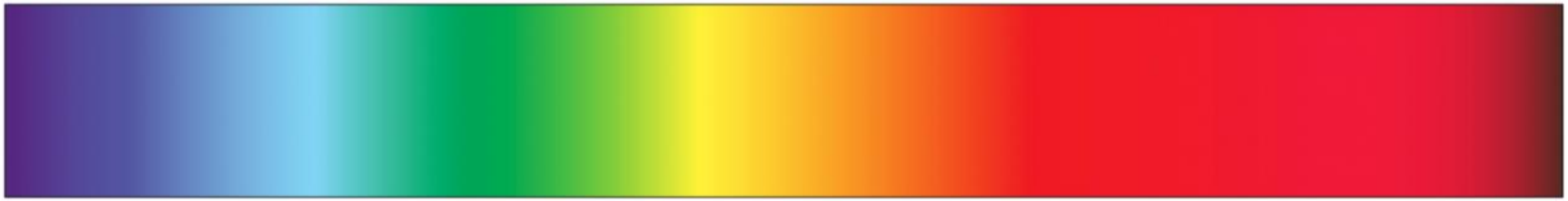
Humans are irrational and will not always approach risk logically, hence the advice process should ensure the product recommendation *actually* meets the client's needs.

Technology has made it easier for clients to access more information, but does that hinder their ability to objectively evaluate their risk appetite?

Risk Tolerance is a spectrum

The challenge for us is where to place the client?

Risk Moderate – *Mix of Insurance*



Risk Averse – *Maximum Insurance*

Risk Comfortable – *No Insurance*

- The insurance relationship to risk is the inverse of the investment relationship.
- The more risk comfortable a client is the less “product solution” they will value via insurance – or may have other alternative mitigation strategies that are more acceptable.
- The more risk averse a client is the much more likely they are to want to purchase more comprehensive insurance policies.
- Finding out where the client sits on this spectrum makes it easier for us to select a mitigation strategy that will align with client values.

Client Attitudes, Values & Beliefs

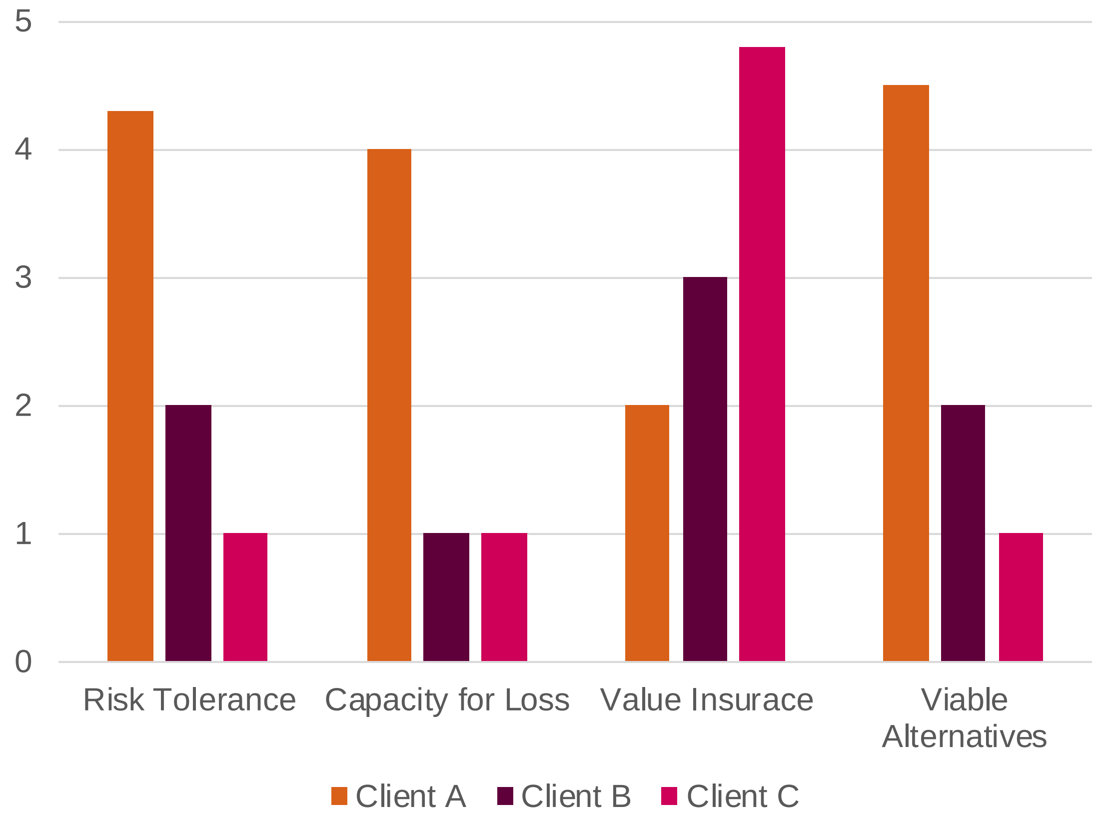
Plotting the position on the spectrum

To start to work out where the client may fit on the risk spectrum, we need to consider existing client attitudes, values and beliefs *away* from Personal Insurance products in their day to life towards:

- Risk Tolerance
- Capacity for Loss
- Attitudes/Values to Insurance
- Viable alternatives to insurance

This will start to build a picture of the personal risk appetite of each individual client.

Client Risk Profiling Examples



Behavioral Finance

What can we learn about client attitudes, values & beliefs?

Unfortunately Humans aren't great at evaluating risks & numbers, so where do we go wrong?

Mental Accounting: We place different values on money based on subjective criteria

Herd Instinct: We follow the actions of others, assuming they have done their research

Loss Aversion: We experience more pain in losing money than gaining the equivalent amount

Anchoring: We value things differently depending on the initial benchmark price

Self Enhancement: We think we are more likely to have better outcomes than the population due to our own 'skill'

Experiential Bias: Because we have experienced something first or second hand we believe it is likely to occur again

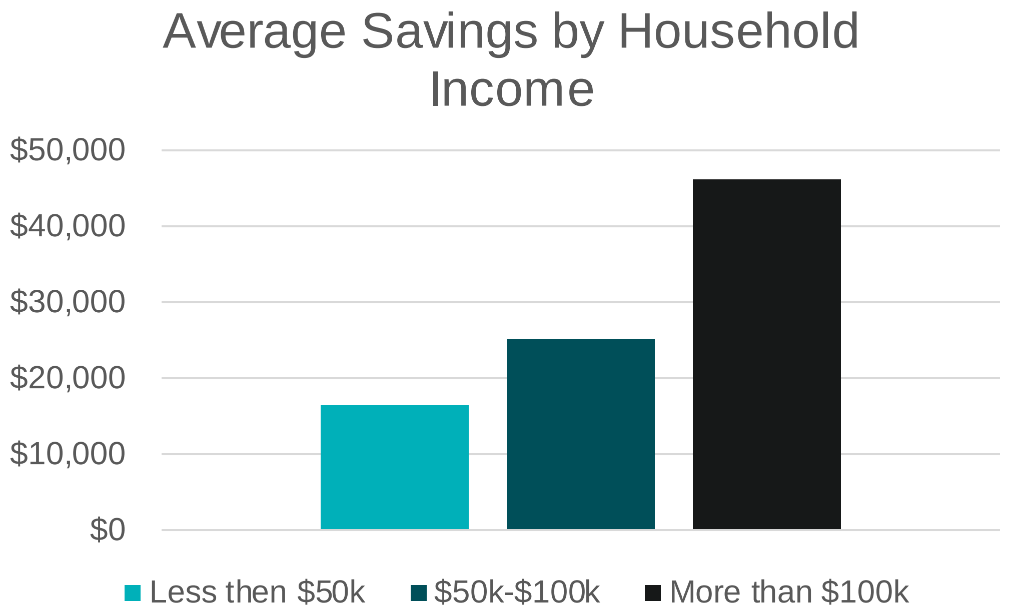
Narrative Fallacy: We love a good story over facts & data

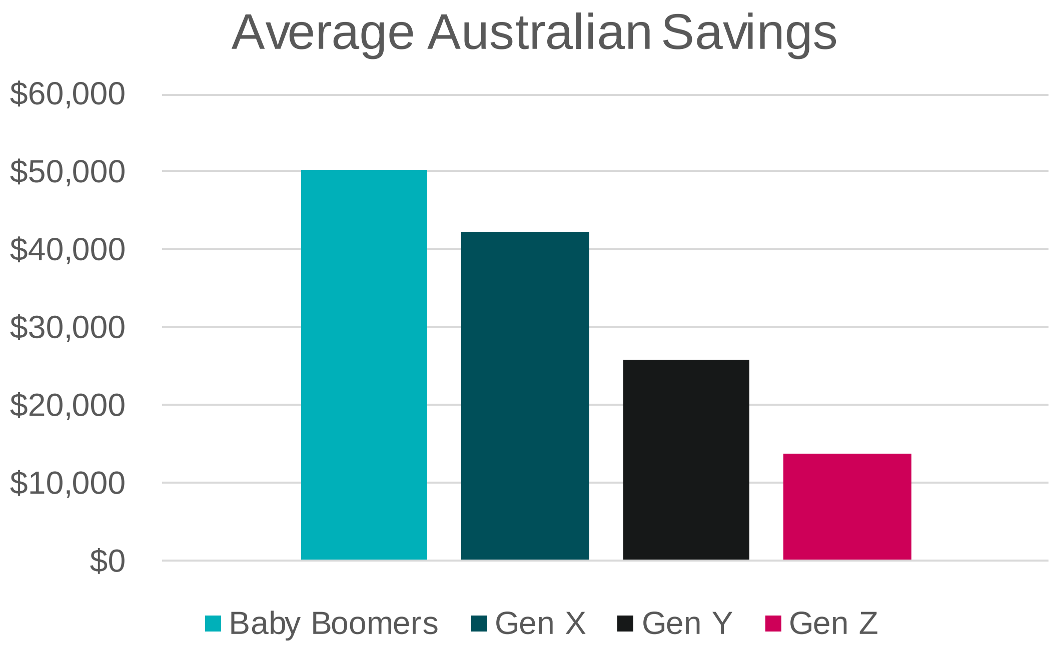
Tolerance to Loss

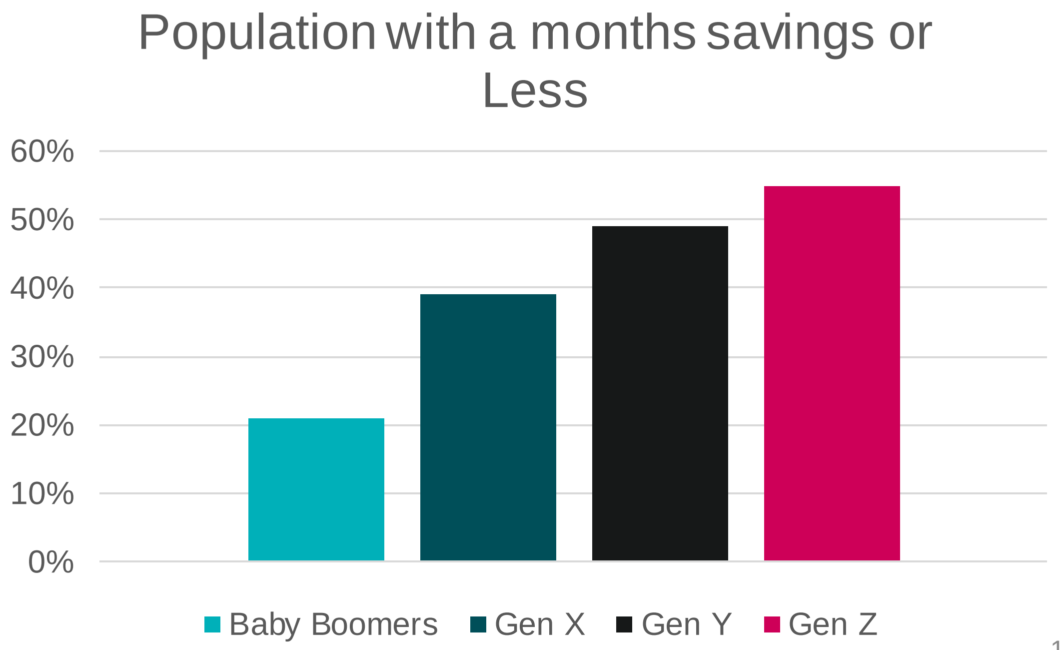
What buffer exists?

Generally, the reason we take out insurance is due to a lack of tolerance to cover the loss in the event of the insurable occurrence.

What is some common data that highlights areas of vulnerability to ask our clients?







Finder Consumer Sentiment Tracker, December 2021

Self-Insurance

What alternative risk mitigation options exist?

Capacity for self-insurance is very different to appetite for self-insurance

While a clients profile may support higher self insurance the consequences matter

Being informed of the true cost of the self-insurance may alter end risk mitigation decision

Alternatives to Insurance	Cost
Realise assets/investments	Loss of future freedom and earnings, tax implications, potential capital losses,
Surplus Cash Buffer	Opportunity cost of using cash for emergency, lost earnings keeping high sums in cash
Additional borrowings/credit	High interest debt, difficulty acquiring additional credit, creating future financial difficulty
Family Financial Support	Potential limit on financial capacity, strain on family relationships.
Social Security/NDIS	Very limited financial support, long wait times for accessing services, severe lifestyle impact, loss of flexibility for accessing services/treatment
Sell Business	Time to find buyer, unrealised value, loss of future earnings

Putting the Profile Together

Poll 2

When asking questions around risk advice my current process…

A) Focuses mainly on obtaining key information around client insurances only

B) Focuses on gathering broad financial information around the clients financial situation beyond insurance

C) Gathers financial information and non-financial information around a clients circumstances when it comes to risk

D) Gets little to no information at all

Elements of an Insurance Risk Profile

What must we consider?

The right questions

More about the qualitative than the quantitative

Don’t need to be specifically life insurance related

Simple and easy to understand

The way we rate responses

Ask on a scale for ratings/responses

Ability to convert response easily into a scale for rating

Ensure we can classify the question into the appropriate category

Example Questions

What can we ask clients?

How comprehensive is your private health insurance?

How high is the excess on your car and home insurance?

How long could you support your expenses if off work?

Do you feel you get value out of your existing insurance products?

Do you expect your debt levels to increase or decrease in the future?

Are you more concerned with a short term or longer term disability?

How comfortable would you feel using some existing assets in the event of lost income?

Do you believe social security provides adequate financial support to maintain your current lifestyle?

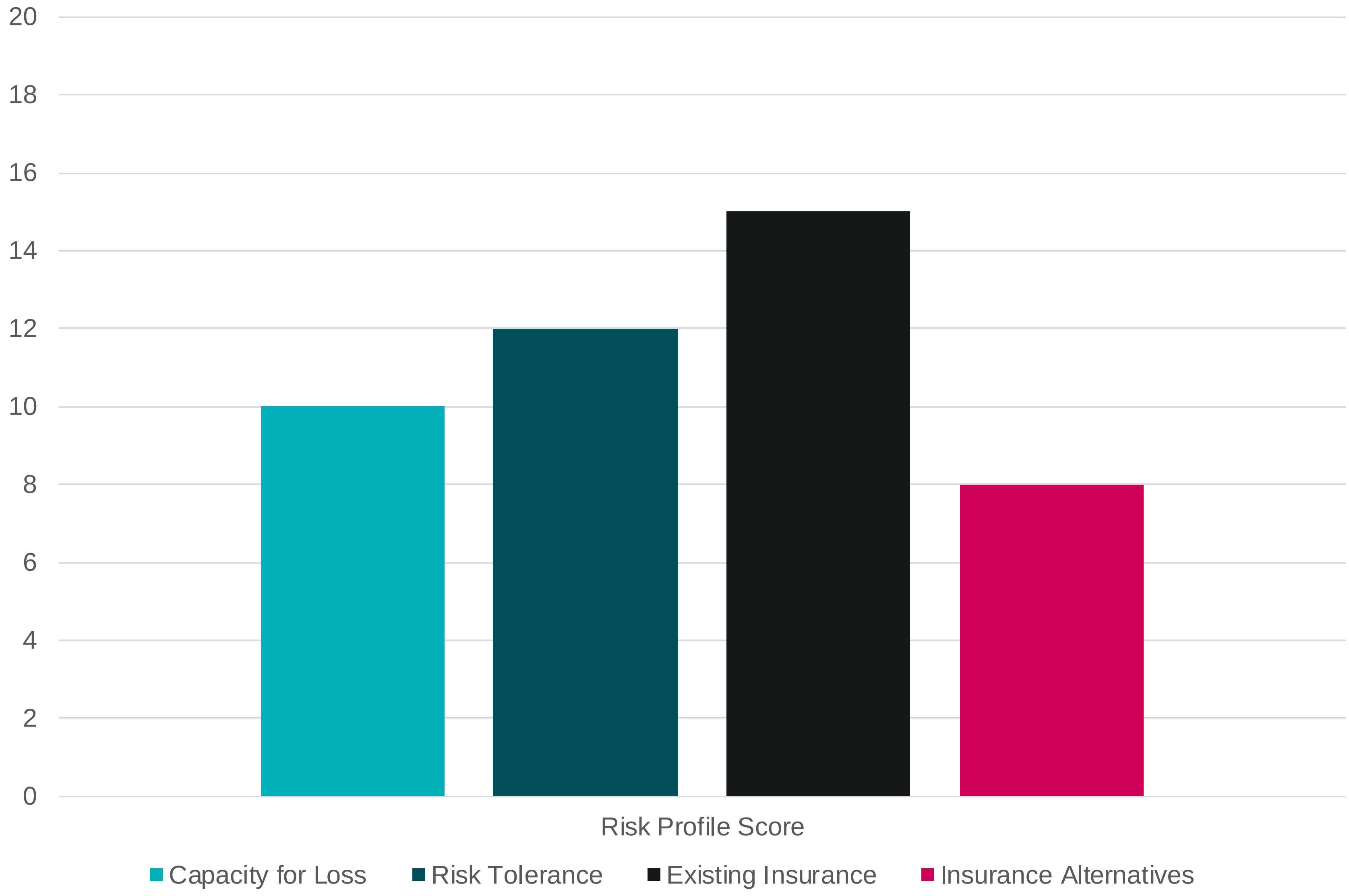
Do you tend to take risks in your financial purchases or decisions?

Have you invested in crypto currency or other digital assets?

Sample Profiling Tool

	Question	Rating (1-5)
Capacity for Loss	Rate how long you would be comfortable living off savings (1 being 30 days to 5 being a year)	2
	Rate how well you would be able to maintain your lifestyle off only your spouses income?	2
	Rate how well you feel you currently meet expenses each month with some savings left over?	4
	Rate how much of your current income you could live off if you needed to (1:70% to 5: 25%)	2
Risk Tolerance	**Question**	**Rating (1-5)**
	Rate the severity of impact on your sense of wellbeing when you lose money	4
	How frequently do you find yourself concerned about financial expenses?	3
	Are you concerned to risk losing money when investing to potentially make money?	2
	Are you often uncomfortable with taking on more debt/your current debt levels?	3
Existing Insurances	**Question**	**Rating (1-5)**
	How would you rate the comprehensiveness of your Private Health Insurance?	3
	How likely would you be to still have Private Health Insurance without the tax/loading penalties?	1
	Would you say you normally prefer to keep your insurance excess as low as possible?	3
	Do you see value in including extras such as physio/chiro or windshield/hire car?	2
Insurance Alternatives	**Question**	**Rating (1-5)**
	How comfortable would you getting family support in the event of being unable to work?	2
	How comfortable would you be selling investments/assets if you needed to fund expenses?	1
	How comfortable would you be using your savings to fund expenses if you needed to?	3
	How comfortable would you be relying on purely NDIS & Centrelink if you were disabled?	2

Sample Profiling Tool



Total Score
45

Low Tolerance (More Insurance)	Moderate (Trade-offs/some insurance)	High Tolerance (Less Insurance)
0-30	30-60	60-80

Objectives & Budget

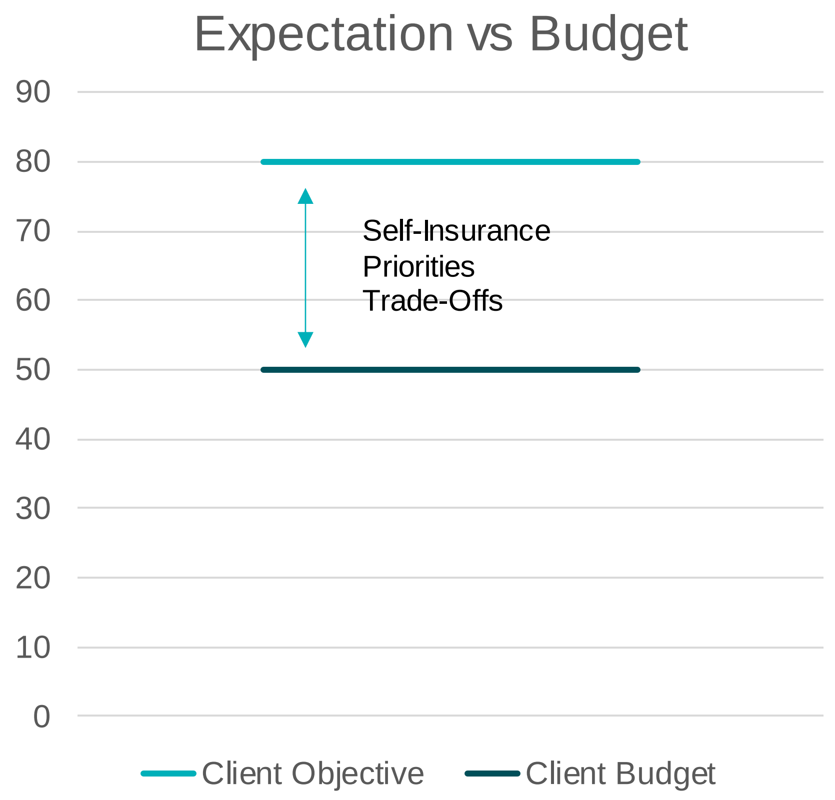
What do we do when they don’t match?

We know a clients risk profile may not always match their stated objectives

It also may not match their real life scenario when it comes to resources available

In risk advice the main resource is budget, which may not stretch to the desired risk solution

What we must do here is help clients prioritise which risks they wish to cover via informed consent



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Trade-Off Conversations

Assessing Risk Trade-Off’s

The Importance Of Trade-Off’s

We arrive at a mitigation strategy through Trade-Offs

It is impossible achieve all client objectives simultaneously, we must educate the client on the trade off options that exist for risk mitigation

The risk profile of the client help inform the likely trade-offs a client will be comfortable with and help remove a lot of post-advice adjustment.

From an ethical perspective it is imperative the client is informed and aware of the risk trade-offs they are making in their protection plan.

Poll 3

When it comes to illustrating risk trade-offs to clients…

A) I work backwards to work out what the client can afford and we agree from there

B) I use a clear process of outlining to the client the elements of their lifestyle they are no longer insuring, and it aligns with their risk profile.

C) I use a tangible tool to illustrate trade-offs and am 100% confident the client understands the risk.

D) B & C

Illustrating Trade-Offs

Helping clients understand consequences

How can we clearly illustrate to clients both the cost and consequences of their risk mitigation choices in a manner that discharges our ethical obligations?

Risk Element	Risk Insured	Risk Self Insured	Mitigation Strategy
Waiting Period	Beyond 30 Days	First 30 Days	Sick Leave
Benefit Period	5 Years	Beyond 5 Years	TPD Insurance & Realisable Assets
Replacement Ratio	70%	30%	Reduction in expenses & spouse income
Superannuation Contributions	Nil	10% of Income	Catch up contributions when return to work

Trade-Offs Post-Advice

Dealing with ATP Adjustments

Risk Profiling should help prevent adjustment	Advice aligned to values	Advice sustainable long term
If something changes?	Refer to initial risk calculation	Agree on elements to be now self-insured/insured
Document appropriately	Save initialled/digitally signed analysis	Include updated trade-offs/analysis in final ATP

Advice Implications

Putting it into Practice

Challenging the Status Quo

Is the traditional comprehensive compliance approach actually meeting client best interest?

89% of Claims are resolved within 2 years

Of claims beyond 2 years, 5% return to work

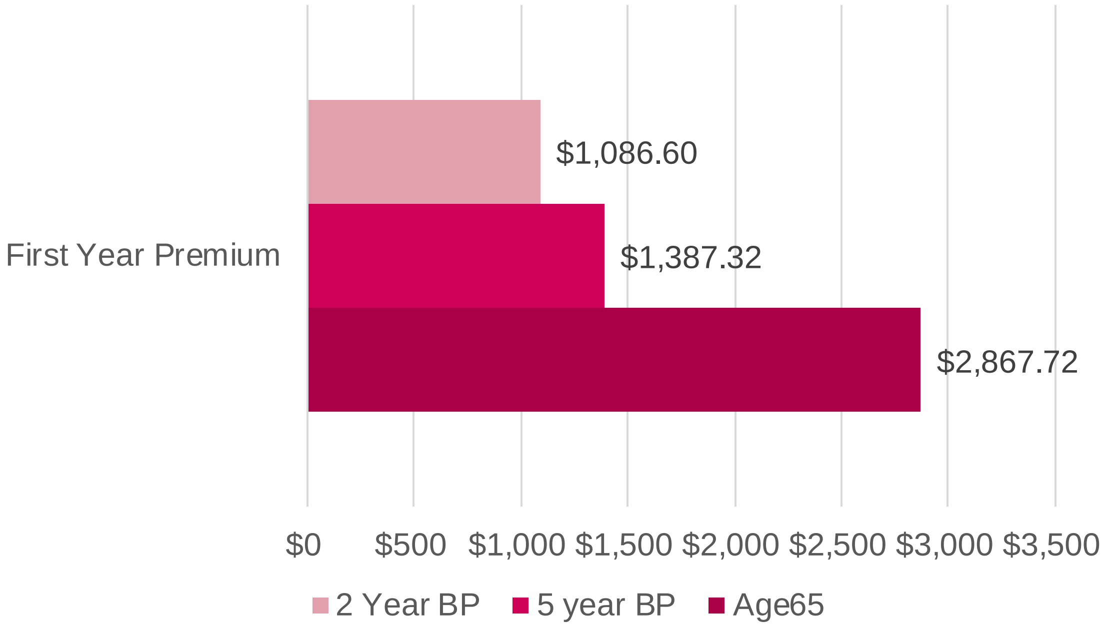
82% of Clients hold age 65+ Benefit Periods

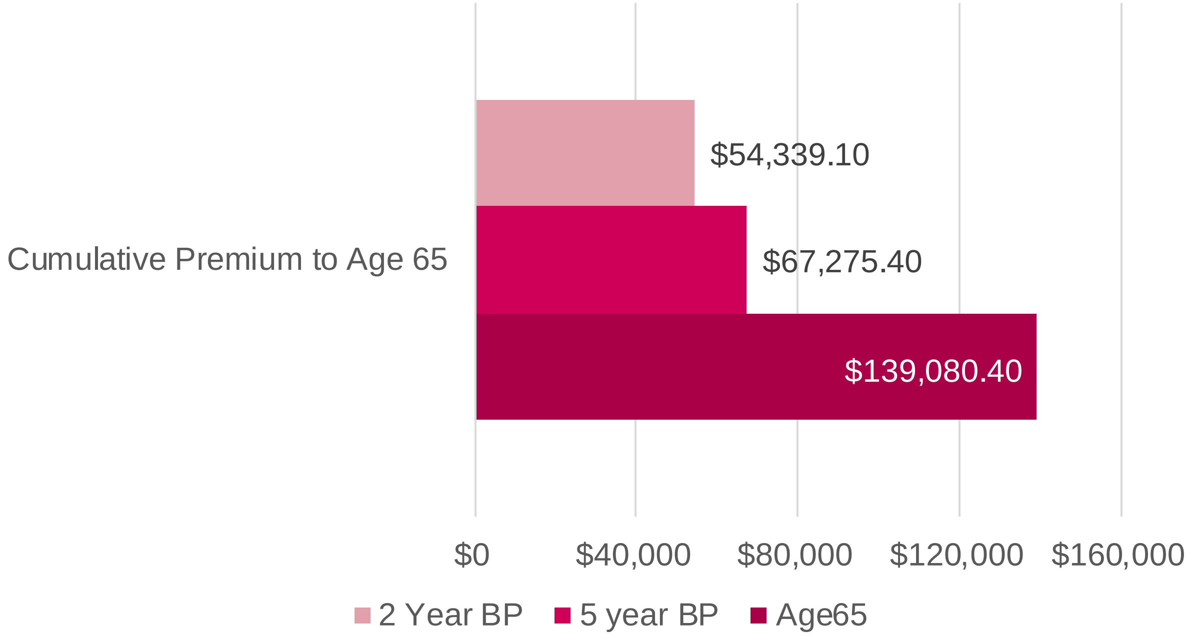
Premium difference on a new policy to 5 year BP approx. 50%

48% of Clients have a 30 day waiting period

Example Scenario

5 Year BP Assure+ Product vs ‘Flat70’ Design





Given approximately 2% of clients claim on income protection in their lifetime, and 89% are resolved within 2 years, what is the opportunity cost of a long term benefit that caters for less than 1% of the total population?

Scenario – Male, 45, AA, $7000/month + SG Benefit, Non-Smoker, includes annual indexation, Income Assure+ Product

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Example Scenarios

How would Risk Profiling apply?

Scenario A

Client Risk Profile

Dave is a 35 year old professional with an income of $150k PA.

He recently purchased his first home and also makes additional contributions to his superannuation and investment accounts for purchasing shares and other high growth investments as he understands that some risk is OK over the long term.

Dave has the most basic private health he could get for tax, and only uses his car a little so took the highest excess he could get as is only concerned with severe scenarios.

He has a clean bill of health but was referred by a family friend who suggested he should cover off some risk around his mortgage and potential loss of income.

What would be some discussion points from the risk profile and potential risk mitigation strategies?

Scenario B

Client Risk Profile Scenario

Mary is a 40 year old working mother with 2 children aged 7 and 9. Her annual income is $90k PA.

Mary and her husband both work, and have a mortgage on their inner city New farm property, while also putting their children through private school.

They have comprehensive home and contents & both cars insured along with top family private health with extras such as dental and physio.

A couple of years ago a family friend was in a car accident and was made TPD. They did get some money from their superannuation but have had hardship since in covering their expenses.

Mary prefers cash savings or to look at property investment in the future and is wary of losing money in the stock market or crypto currency. She is quite concerned with the media talk of potential recession, especially with how tight the family budget is with their expenses.

What would be some discussion points and potential strategies for Mary?

Ongoing Review

Risk Appetite is Fluid

In-Force Management

Adjusting Risk Profile at Renewal

Risk Moderate – *Mix of Insurance*

Risk Averse – *Maximum Insurance*

Risk Comfortable – *No Insurance*

Risk appetite will change over time, so it’s important the risk mitigation strategy is regularly reviewed

Can we use digital tools to automate that process, update information and maintain client engagement?

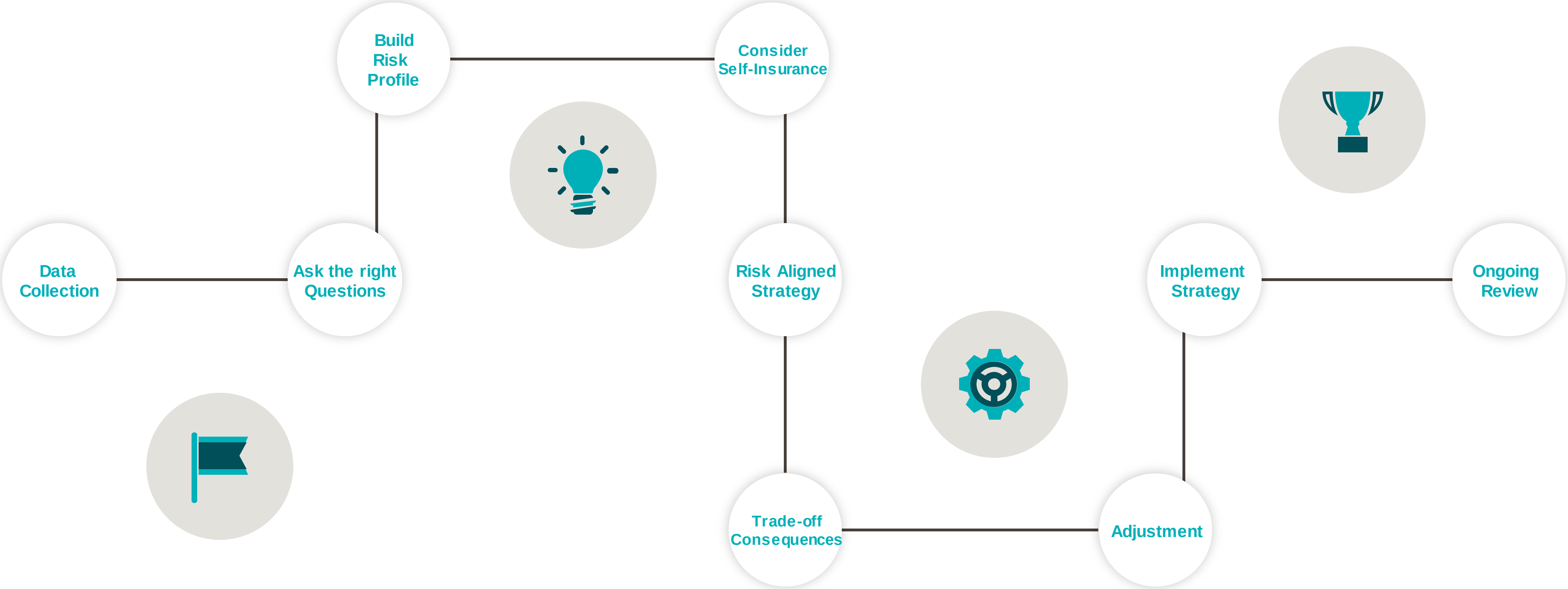
Keep file up to date of client changes and situation along with the process being used for ongoing engagement

How can we use this data strategically to create further advice or referral opportunities and add value?

Next Steps

Where to from here?

Risk Profiling Process



Through a collaborative process we can help clients understand their personal risk and arrive at a mutually acceptable mitigation strategy

Additional Materials

Resources & Educational Sessions

Head to the MLCL Adviser Portal for On-Demand CPD Sessions

Technical & strategy questions:
rdptraining@mlclifeinsurance.com.au

Reach out to your MLCL BDM for Copy of Materials

Monthly Live Q&A Sessions on LinkedIn Live

Register for June Webinar Building a Modern Insurance Philosophy

Questions?

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