



**INSTITUTE OF FINANCIAL ADVISERS INC.**

**GUIDELINES ON  
REPLACEMENT BUSINESS**

**EFFECTIVE  
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## Background

Replacement business, particularly in personal risk products is a difficult ethical area. The aim of this guideline is to define what is appropriate, and factors that should be considered by a financial adviser before recommending a client replace a policy.

Any replacement business decision should be based on the core principle that an adviser should act in the client's interest, first, last and always.

Replacement Business is an emotive issue within the industry, with many stakeholders having strongly held and often conflicting views. There is significant disagreement amongst supplier companies, advisers and consumer advocates. Regardless of any individual opinion as to the appropriateness of replacing one insurance contract with a new one, it remains a daily occurrence in the industry, and an activity that is endorsed by many stakeholders.

## Discussion

The central issue in any ethical debate should be "what is best for the client?" The answer will vary from client to client, but a simple ethical test would state:

**"It is appropriate to replace one insurance product with another if the replacement results in the client being in a better position after policy replacement than they would have been, had they retained the original contract."**

This ethical test should then be reinforced with appropriate documentation by the adviser conducting the replacement, that highlights the advantages and disadvantages of any such business replacement to the client.

The test of whether a client is in a better position might consider the following questions:

- Are there additional benefits in the new contract being applied for, that significantly advantage the client?
- Is there any loss to the client in benefits or levels of cover, in changing the existing product?
- Is the type of cover provided by the existing contract now inappropriate or no longer "reasonably expected to meet the needs of the client"?
- Is the existing cover, or the definitions associated with it, now so fundamentally changed as to increase the risk of avoidance at claim time and disadvantage the client?
- Have the client's circumstances altered in such a way that the existing contract no longer provides the certainty of cover that it previously did?
- Has the client's health, occupation or other material factors changed substantially, resulting in better coverage or better pricing options with a different insurer?
- Has the client's personal health, occupation or other material factors changed in any way that may adversely affect the new cover, by way of additional premiums or exclusions on cover?
- Have the product providers' circumstances altered in such a way that the existing contract no longer provides the certainty of cover that it previously did?

There is an additional factor that is perhaps not strictly speaking an ethical question – that of "cost". It should be determined if policy cost is an issue for the client, and if so, whether the cost of the new product is the same (or lower) for the additional benefits being provided to the client.

If the cost is not the same (or lower), are the additional benefits arising from policy replacement sufficient to warrant the proposed increase in cost to the client?

This list is not exhaustive, but is indicative of the issues that should be considered in determining whether product replacement is in the client's best interest. If there are no clear benefits to the client in replacing one contract with another, or a loss of benefits in the existing contract occurs, then a strong case exists for asserting that the adviser has been primarily motivated by self-interest.

As each replacement business case must be judged on its own merits and in the best interest of the client concerned, it is dangerous practice for advisers and clients alike to exercise "mass takeover" terms for entire books of business. Invariably when dealing in bulk transfers there will be increased risk of a specific client's individual circumstances not being taken into account. A general principle should be that if a single client is placed in a worse position by an adviser exercising a blanket offer to switch a large number of clients from one supplier to another simultaneously, then the adviser is responsible.

### **Practical matters and Process**

Once it has been decided by the client, in consultation with the adviser, that replacement business is in their best interest, there is a requirement for the adviser to support and document that recommendation in a professional manner.

At the very least, an adviser should use the ISI Advice on Business Replacement Form as a means of documenting what is being replaced, with what, and why it is being done. However this document is extremely limited and would not generally fulfil the requirements of ethical best practice according to international standards.

For this reason, if replacement business is recommended, a written **Statement of Advice** should be provided to the client highlighting the following areas:

- My advice
- The consequences of replacing one financial product with another
- The reasons for replacement (including assumptions and any data to support the decision)
- Any limitations; such as suicide exclusion and trauma / TPD delays
- The risks or disadvantages in my advice
- Full disclosure of remuneration and conflicts of interest

This advice and all the supporting documentation should ideally be signed off by the client. If the Business Replacement meets the ethical test, and is substantiated in a document to the client clearly covering these key points, then there is little risk of the adviser being held to have acted inappropriately.

There is a responsibility on the adviser to manage the process of transition from one insurer's policy to another on behalf of the client. **Existing (in force) insurance policies should never, under any circumstances, be cancelled by the adviser prior to having the replacement insurance policy in force and cover accepted by the new insurer.** If there are stand-down periods for coverage under a new policy (e.g. trauma conditions not covered for first 90 days of the new contract), then the client must be able to make an informed decision about the possibility of a partial lapse in cover ***prior to cancellation*** of the existing coverage.

It is best practice (whether replacing an existing insurance policy or putting in place a new policy for the first time) to provide a copy of the client's personal statement, as submitted to the insurer, to the client for their own records, together with a written instruction advising the client of the danger of errors, omissions or insufficient detail in regards to their proposal. If this is done, there can be little scope for anyone involved in the process misinterpreting the questions or not understanding the implications of answering incorrectly.

### **Conclusion**

The risk will still exist that some within the industry will label any Insurance Business Replacement as "churning" or "twisting" and being a generally "bad thing". However, many others would argue that the adviser who does not begin the review process with a clean slate and consider all possible solutions for the client is not acting in the client's interest to begin with. That debate can continue, though it is irrelevant to the client.

The central issue remains whether you are acting in your client's best interest - the fiduciary rule - as judged by your professional peers and whether it is being done in such a way that the client is able to make an informed decision.

The secondary, but still essential feature, is that the correct process is employed to ensure the decision is justified and incurs no risk to the client of lapses in coverage.

### **Guidelines on Replacement Business**

Advisers providing advice on replacement insurance should

1. Always put the client's interests first.
2. Test whether or not the new contract would be advantageous for the client, identifying advantages and disadvantages, limitations, risks and benefits.
3. Document the advice to the client in a written Statement of Advice.
4. Provide the client with a copy of their personal statement to the insurer and warn them of the danger of errors, omissions or insufficient detail in regards to their proposal as well as the obligation to notify changes to their circumstances prior to the policy coming into force.
5. Carefully manage any transition including ensuring that existing cover remains in place until the replacement policy is fully in force.
6. Avoid "mass takeover" arrangements as these do not allow the circumstances of every individual client to be given the necessary detailed evaluation and advice.

Tony Vidler, CFP, CLU

Garth Clarricoats, CLU, AFP