

Building A Life Insurance Philosophy For Your Business

A practical Workshop for financial advisers

August 2025

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Learning Outcomes

At the conclusion of this presentation, attendees should be able to:

- Understand the need for an insurance philosophy to ensure compliance with regulation in this changing world.
- Appreciate the benefits of a robust insurance philosophy as an effective tool for delivering client service.
- Be aware of the key components of an insurance philosophy.
- Develop a consistent and structured approach to the calculation of insured amounts for life, TPD, and trauma insurance.

Agenda

- 1 Insurance philosophy building blocks
- 2 Identifying and quantifying risk
- 3 Insurance versus self-insurance
- 4 Drivers behind insurance choice
- 5 Discussion 1: Applying your insurance philosophy to the inside/outside superannuation choice
- 6 Discussion 2: Applying your insurance philosophy to setting trauma insurance amounts

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**1 Insurance philosophy
building blocks**

The importance of an insurance philosophy

The core need for insurance advice has not changed. The way we are expected to use the wisdom underlying our professional competence has changed and we will be scrutinised by clients and regulators. How do we respond to this situation?

A properly formulated insurance philosophy is the foundation of compliant advice delivery. **The insurance philosophy should:**

- articulate your insurance methodology
- be an important compliance tool supporting your risk advice
- substantiate advice and be instrumental in helping you meet Best Interests duties

ADVICE INFORMS PRODUCT

We need a structured repeatable process based on core beliefs that ensure that we deliver advice which is in the client's best interests and is appropriate to the client's needs.



Philosophy = the love of wisdom

Articulated position so that advisers and clients understand fundamental truths behind the advice



Gives advisers and clients a structured thought process and methodology which is compliant and adds value



Prompts advisers to think about the client and what matters most to the client



Insurance philosophy benefits



Uses risk as a starting point and explores alternative risk mitigation techniques

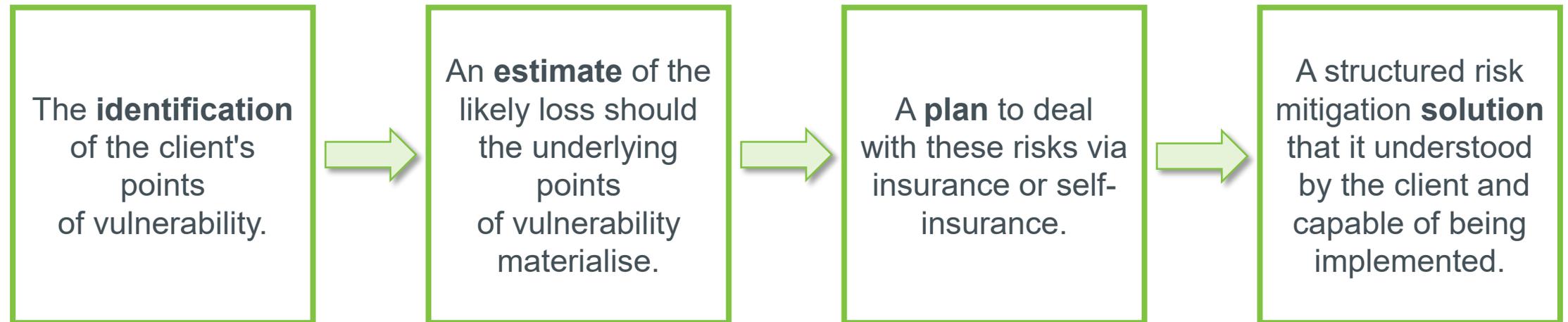


Assists the client to make informed choices based on risk appetite and cost



Output is a sustainable risk management plan which provides peace of mind

The ultimate deliverable





2 Identifying &
quantifying risk



Risk identification

The insurance philosophy should articulate the risk identification via an appropriately structured fact find process

Points of vulnerability

Risk is identified by considering points of vulnerability. The insurance philosophy should articulate the process of identifying the points of vulnerability. Typically, points of vulnerability could include:

- Debt
- Child-care
- Lifestyle maintenance
- Education costs
- It is also important to consider whether the clients have vulnerabilities in their business and superannuation arrangements



Risk quantification

Risk only has meaning to the client if there is an estimate of the loss in dollar terms if the identified risk materialises

Loss estimates

Separate the risk into its components to assist client understanding

- Debt risk: calculation is based on the amount of the debt
- Income risk: After tax income over the client's estimated working life
- Business equity risk: exposure is based on the value of the client's business
- Child-care risk: estimated cost of child-care using benchmarks such as NATSEM Income and Wealth Report
- Education risk: cost of educating children to the desired level at a suitable educational institution
- Cash flow risk: The present value of cash flows required to maintain lifestyle excluding the items listed above

Use a calculator to quantify risk exposure

Item	Amount (AUD)
Annual Pre-Tax Income	\$150,000
SGC Contributions	\$15,750
Mortgage Repayments	-\$25,000
Child Care	-\$53,797
Taxation	-\$39,838
Residual Income	\$47,115
Estimated Working Life (Years)	17
Provision for Cost of Home/Lifestyle Modification (based on residual)	\$43,735

Insured Amount Components Life Cover	Risk Amount	Transfer	Retain
Debt Risk	\$500,000	–	\$500,000
Child Care Risk	\$515,515	–	\$515,515
Education Risk	\$149,263	–	\$149,263
Residual Cash Flow Risk (Per Workings)	\$874,700	–	\$874,700
Other Risks	–	–	–
<i>Quantified Risk Before Adjustment</i>	<i>\$2,039,477</i>		<i>\$2,039,477</i>
<u>Reduction in Insured Amount</u>			
Superannuation	–	–	–
Proceeds from Sale of Assets	–	–	–
Working Spouse	–	–	–
Other Funding Sources	–	–	–
Total Reduction in Insured Amount	–	–	–
Recommended Life Insurance Amount	\$2,039,377		\$2,039,377

Insured Amount Components Life Cover	Risk Amount	Transfer	Retain
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Education Risk	\$149,263	–	\$149,263
Residual Cash Flow Risk (Per Workings)	\$874,700	–	\$874,700
Provision for Cost of Home/ Lifestyle Modification	\$43,735	–	\$43,735
Other Risks	–	–	–
<i>Quantified Risk Before Adjustment</i>	<i>\$2,083,212</i>		<i>\$2,083,212</i>
<u>Reduction in Insured Amount</u>			
Superannuation	–	–	–
Proceeds from Sale of Assets	–	–	–
Working Spouse	–	–	–
Other Funding Sources	–	–	–
Income Projection Adjustment (2 Year Benefit)	–	–	–
Income Projection Adjustment (5 Year Benefit)	–	–	–
Income Protection insurance (age 65 benefit)	–	–	–
Total reduction in insured amount	–	–	–
Recommended TPD insurance amount before tax	–	–	–
Tax gross up (TPD in Super Only)	–	–	–
Recommended TPD Insurance Amount	\$631,589		\$631,589

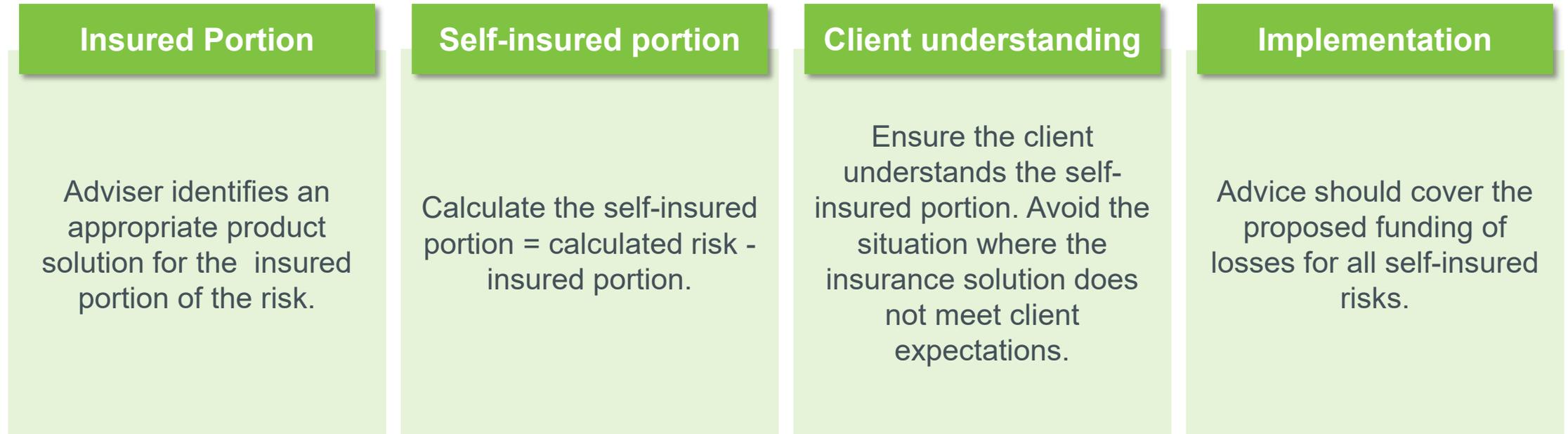
Always test the validity of calculator outputs



3 Insurance versus self-insurance

Insurance choice process

- Once the risk has been quantified, the client needs to choose to insure the risk or self-insure the risk
- The quantified risk does not change



Use the “Risk Matrix” to cover both insured and self-insured risks. Complete a separate matrix for each spouse as their needs differ.

Risk matrix capital risk(1)

RISK	EXPOSURE	RISK TRANSFER STRATEGY			RISK RETENTION	RISK RETENTION STRATEGY
		LIFE	TPD	CI		
Debt on primary residence	\$300,000	\$300,000	\$300,000	\$0	\$300,000 (trauma)	Fund any shortfall payments from earnings or trauma insurance claim proceeds. Default to using savings or social Security in a worst-case scenario.
Child maintenance	\$388,000	\$388,000	\$388,000	\$0	\$388,000 (trauma)	
Education funding	\$172,000	\$172,000	\$172,000	\$0	\$172,000 (trauma)	
Cash flow replacement	\$339,000	\$339,000	\$339,000	\$0	\$339,000 (trauma)	
Total	\$1,199,000	\$1,199,000	\$1,199,000	\$0		

Risk matrix capital risk(2)

IDENTIFIED RISK	EXPOSURE	RISK TRANSFER STRATEGY			RISK RETENTION	RISK RETENTION STRATEGY
		LIFE	TPD	CI		
Total B/F	\$1,199,000	\$1,199,000	\$1,199,000	\$1,199,000	\$0/\$1,199,000	
Home modification/medical	\$200,000	\$0	\$200,000	\$200,000	\$0	Rely on savings or social security to fund losses in excess of best estimates
Final expenses	\$20,000	\$0	\$0	\$0	\$20,000	Retain the risk. Fund items from household cash flows
Total	\$1,419,000	\$1,199,000	\$1,399,000	\$200,000	\$20,000	
Super	(\$300,000)	(\$300,000)	\$0	\$0	\$0	Balance in superannuation can be paid as a death benefit
Income protection adjustment	(\$321,000)		(\$321,000)			NPV of income payable under the 5 years benefit period under the income protection policy
Total	\$798,000	\$899,000	\$1,078,000	\$200,000	\$20,000	

Risk matrix income risk

RISK	EXPOSURE	RISK TRANSFER STRATEGY	RISK RETENTION	RISK RETENTION STRATEGY
Amount of income lost	\$8,333 per month	\$5,833 per month	\$2,500 per month	Client is compelled to self-insure
Duration of the loss	Loss of monthly income to age 65	\$5,833 per month for 5 years	\$8,333 per month after 5 years	Rely on TPD insurance to cover most of the exposure. Uncovered portion estimate 1%
Waiting period	Monthly expenses of \$5,000 without income	Expenses met by monthly benefit	First 60 days of household expenses. Estimate \$10,000	Rely on annual and sick leave payments from employer to cover expenses in the first 60 days post loss of income
Loss of retirement savings	\$1,000 per month	Nil	\$1,000 per month	Meet payments from monthly benefit or lump sum cover

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4 Drivers behind insurance choice

Drivers

An insurance philosophy should require the consideration and evaluation of each driver. This ensures that each client receives appropriate cover.



Cost



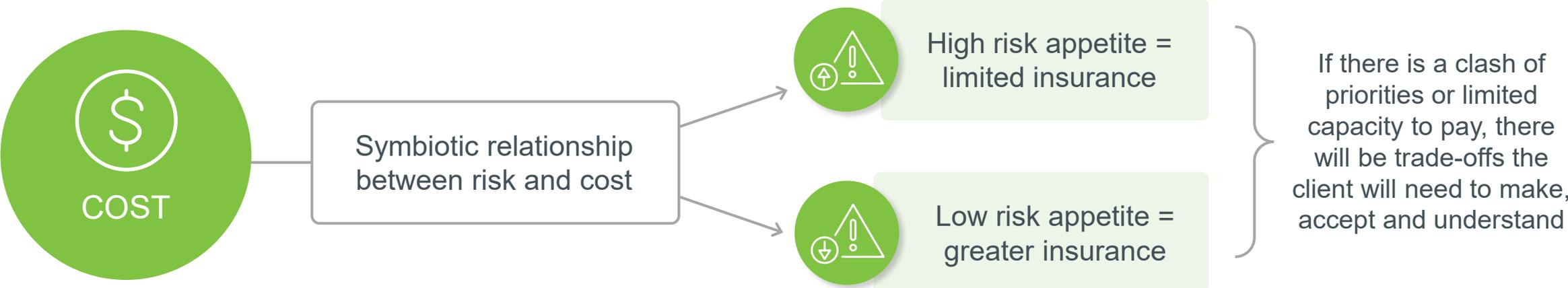
Attitude to risk



Trade-Offs

Appropriate cover is not necessarily the most comprehensive cover available

Cost



Attitude to risk



Identify risk appetite using a series of questions designed to place the client on the risk spectrum.



Help the client understand their attitude to risk as it relates to protecting wealth.



Consider the impact of any embedded behavioural bias e.g. overconfidence, recency, loss aversion.



Trade-offs

Examples of client trade-offs

- IP funded through super / erosion of retirement savings
- Repayment of mortgage debt/ comprehensive insurance cover. Priority is given to repayment of mortgage debt with reduced insurance cover
- Building retirement savings/ comprehensive insurance cover. Client gives priority to retirement savings by taking limited insurance cover.
- Lifestyle priorities e.g. luxury car / comprehensive insurance cover

Insurance advice is a delicate balancing act

- A trade-off is essentially a balance achieved between two desirable future states
- Intuitively, clients would prefer comprehensive coverage covering all contingencies, practically that would be expensive to price, and the cost would outweigh the benefits
- Understanding the client's belief of value against their existing expenditure will help start the discussion on the concept of trade-offs and their preference as they relate to insurance coverage
- Many clients lack the resources to meet all their goals. This compels clients to identify the priority goal and devote resources to the priority goal. The residue is then allocated to the secondary goal

Testing advice outcomes

The rubber hits the road if a claim is made under the insurance policy

Stress test advice to ensure compliance with the “Golden Rule of Insurance”



Golden Rule is ensuring that the right amount is paid in the right form to the right person at the right time.



The cash flows on claim should be mapped so that clients and beneficiaries understand what happens on claim.



The risk of adverse impact to cash flows should be assessed from a tax, regulatory risk and legal perspective.



Strategies may need modification post this risk assessment.

5

Discussion 1: Inside/Outside superannuation choice

Inside versus outside super discussion

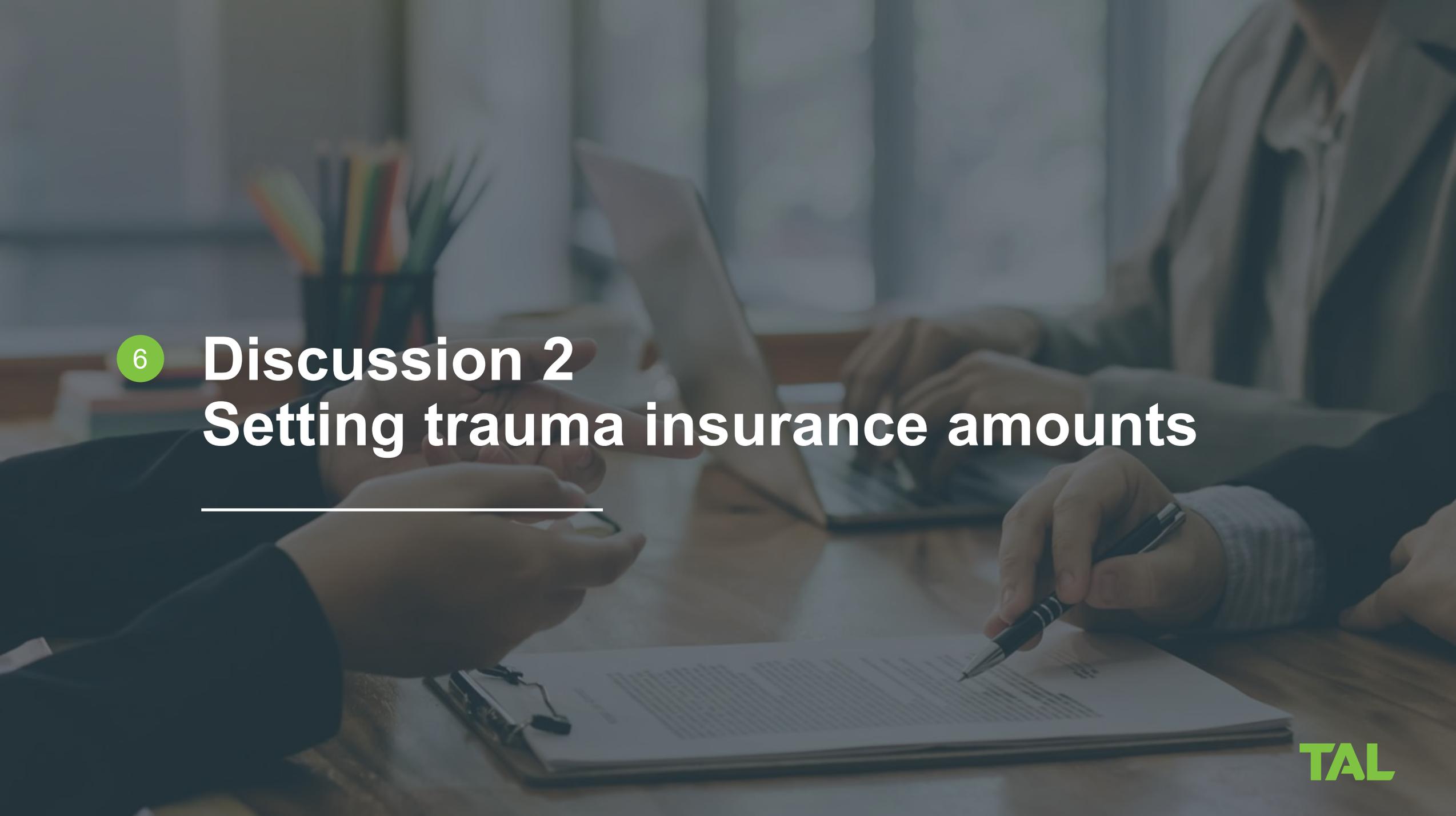


Select a spokesperson for reporting

10-minute table discussion followed by report back

Topics to discuss

- Why do we use a superannuation structure for insurance solutions?
- What are the disadvantages of insurance in super?
- How do we calculate the potential erosion of retirement savings?
- How do you approach a client aged 45 versus client aged 52?
- How should the insurance philosophy cover the insurance in superannuation topic?



6 Discussion 2
Setting trauma insurance amounts

Setting trauma insurance amounts



Select a spokesperson for reporting

10-minute table discussion followed by report back

Topics to discuss

- Consider out of pocket medical expenses incurred when somebody falls ill
- What is the impact of private medical cover?
- What does the Zurich Cost of Care Report indicate?
- How do we deal with the numerous permutations of potential disease and the cost of treatment?
- How should the insurance philosophy cover the trauma insurance amount topic?

Calculation of Trauma Sum Insured:

- 25% income of family unit + 25% Mortgage
school fees x 5 years x Kids
medical expenses - client directed
- 6-12 months life insured salaries
200K medical + client directive
- 1 year income
150K medical
- 25% x 2 years insured salaries
110K medical
- 6 months living cost & debt repayment
- client directed medical
- Base case 1 mill
- 25% L.I income 2 years
Mortgage repayments 2 years
client directed medical
- 150K + client directed

A glowing lightbulb hangs from the ceiling in the center of the frame. The background is a blurred office or meeting room with a brick wall and several people sitting around a table, appearing to be in a collaborative work environment. The overall lighting is dim, with the lightbulb providing the primary source of illumination.

Questions & TAL support

How do I move forward?



Start slow, examine your advice processes and apply the learnings from today's session. Start formulating your insurance philosophy using an appropriate template and adjust as your thoughts develop.



TAL has a number of resources including the TAL Risk Academy that covers these learnings in more detail.



Speak with your TAL BDM about how they might be able to assist you.

TAL Support

TAL offers the following support materials to assist advisers in the development of their insurance philosophy.



Insurance
philosophy
template



Risk matrix
templates



Insurance
amount
calculator



Insurance
amount case
study



Client risk
profiling tool